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No.

In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

COUNTY OF SAN DIEGO, CALIFORNIA;
GREGORY J. SMITH, SAN DIEGO COUNTY ASSESSOR; and
PAUL BOLAND, SAN DIEGO COUNTY TAX COLLECTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether a federal contractor that manages research equipment owned by the United States may be subjected to a state *ad valorem* property tax with respect to that equipment solely because (i) the contractor obtains "knowledge" from its management of the research equipment and (ii) that "knowledge" has an incidental, independent commercial value.

2. Whether, if a federal contractor may be subjected to a state property tax in these circumstances, the tax may be based upon the value of the property owned by the United States—a value that has no relationship to the value of the "knowledge" that the contractor purportedly obtained.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinions of the court of appeals (App., *infra*, 1a-10a, 11a-26a) are reported at 53 F.3d 965 and 965 F.2d 691. The opinions of the district court (App., *infra*, 27a-44a, 45a-49a) are unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 50a) was entered on April 24, 1995. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2, of the United States Constitution, 28 U.S.C. 1345, and Sections 104, 105 and 107 of the California Revenue and Taxation Code (West 1987) are reproduced at App., *infra*, 51a-52a.

STATEMENT

1. The United States Department of Energy funds and administers nuclear fusion research at several locations throughout the country. The object of this research is to develop a magnetically confined fusion reaction system that is capable of generating commercial electric power. As part of this technically complex program, the Department has contracted for research and engineering services from private industry and universities (App., *infra*, 27a-28a).

Since 1963, the Department has engaged in a series of research management contracts with a private scientific research firm named General Atomics. These contracts require General Atomics to assemble, maintain and operate a large federally owned experimental fusion device at the contractor's facility in San Diego, California.[1] General Atomics is reimbursed for the costs it properly incurs in performing this contract, including applicable state and local taxes. In addition, General Atomics is paid an annual fee of approximately $2.5 million for its services (App., *infra*, 12a-13a). The contracts between the

[1] Two nuclear devices were used during the period relevant to this litigation. The D-III device was in use from 1978 until it was dismantled in 1984. The D-IIID device was then built and has remained in use since 1986 (App., *infra*, 2a & n.1). In this petition, the two devices are referred to collectively as the "device."

Department and General Atomics are subject to unilateral termination by the government (*id.* at 12a).

The experimental fusion device is the exclusive property of the United States and is maintained by General Atomics in a building located on the contractor's property. The Department retains complete control over access to the device by all persons, including the employees of the contractor (App., *infra*, 28a).[2] During the period relevant to this litigation, the fusion device weighed between 400 and 500 tons (CR 19, at 9):

> The * * * device itself and its associated equipment are a complex assembly of thousands of individual components and systems, including many assemblies and subassemblies. When components can no longer meet the requirements of the changed or upgraded experiment they are removed and new components are designed and added to the assembly. Hence, the very nature of the experiment requires that the device can be taken apart so that its numerous components can be disassembled, modified, altered or moved to new locations.

From time to time, the device has been disassembled, reassembled and modified. Various parts of the device have been transferred by the Department to other

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[2] The government of Japan also provided financial resources for this fusion research program. In return, between 1980 and 1985, the United States granted Japan fifty percent of the time available for experimental use of the device (CR 89 (Steele Decl.) at 1-7) ("CR" refers to the docket control numbers assigned to documents in the original record by the clerk of the district court and transmitted to the court of appeals).

sites for use in associated research projects (App., *infra*, 28a).

General Atomics has no control over the device, the components of the device or the transfer or relocation of those components by the Department. Use of the fusion device by General Atomics is strictly limited to the specific operational and management tasks required in performing its contract with the Department. The Department has permitted no other uses of the device by the contractor. App., *infra*, 28a; CR 17 (Beighly Decl. at 6)).

2. Respondents are the County of San Diego, its assessor and its tax collector. In the course of an audit conducted for the 1978 and 1979 tax years, respondents determined that General Atomics had a "possessory interest" in the Department's experimental fusion device that was subject to tax under the State's *ad valorem* property tax, Cal. Rev. & Tax. Code §§ 104, 105, 107 (West 1987).

California imposes an annual *ad valorem* tax on the ownership or possession of land and improvements within the State. Cal. Rev. & Tax Code § 104 (West 1987). A "possessory interest" is the taxable interest that stems from the "[p]ossession of, claim to, or right to the possession of land or improvements" (*id.* § 107). The term "improvement" is defined under state law to include all "buildings, structures, fixtures, and fences erected on or affixed to the land." *Id.* § 105.

Respondents took the position that the "possession of" the government's experimental fusion device by General Atomics gave it a "possessory interest" that was subject to tax under state law (App., *infra*, 13a). Respondents therefore issued property tax as-

sessments against General Atomics for an imputed value of that "possessory interest" in the device for the years 1978 through 1985 and 1987 through 1989. Respondents valued the contractor's "possessory interest" by assuming, with certain adjustments, that the contractor had an interest equivalent to a 30% share of a five-year lease in the use of the fusion device.[3] Based on this valuation, respondents assessed a total amount of tax, penalties and interest for the years at issue of approximately $1,300,000 (*ibid.*).

General Atomics paid the taxes assessed for 1978-1981 and 1987-1988 ($568,002) but did not pay the taxes assessed for 1982-1985 and 1989 ($721,-979). Under the terms of the federal contract, the United States reimbursed General Atomics for the

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[3] See CR 89 (Steele Decl. at 2-3); CR 39 (Mem. of the United States at 19-20). Under what the State refers to as the "indirect cost approach," the tax assessor calculates the present value of the taxpayer's possessory interest in property by determining (i) the cost of the property in which the taxpayer allegedly has a possessory interest, (ii) the average life and salvage value of the property, (iii) the duration and extent of the taxpayer's right to use the property, (iv) any reversionary interest and salvage value of the property and (v) the appropriate allowance for depreciation. The tax rate is applied to the resulting valuation to determine the tax to be paid. See California State Board of Equalization, *The Appraisal of Possessory Interests* at AH 517-22 to AH 517-25 (Feb. 1974).

The facts relating to the appraisal and tax calculations made by respondents have not been developed in detail in the opinions in this case. At respondents' urging, the district court concluded that it need not address the factual details of the challenge of the United States to the appraisal and valuation methodology applied by respondents. See App., *infra*, 46a-48a; page 11, *infra*.

taxes it paid to respondents (App., *infra*, 13a). Although the assessment was challenged before the county assessor, neither the United States nor General Atomics thereafter filed state-law refund claims with respondents or with the state government (*id.* at 9a).

3. In 1989, the United States commenced this action in federal district court under 28 U.S.C. 1345.[4] The United States sought a declaratory judgment (i) that the tax that respondents sought to impose was on property owned by the United States and was therefore in violation of the Constitution, (ii) that the asserted "possessory interest" of the contractor in the government's fusion device had been improperly and unlawfully valued and (iii) that the contractor's responsibility to maintain and manage the government's fusion device did not provide it with a "possessory interest" in that device under state law. The United States sought an injunction against any further actions to assess or collect the challenged tax and a refund from respondents of the taxes, interest and penalties already paid (App., *infra*, 3a; CR 1, at 11-13).

a. In the first of its two opinions in this case, the district court granted partial summary judgment to respondents (App., *infra*, 27a-44a). The court acknowledged that a state tax (i) may not be levied directly on federal property and (ii) may constitu-

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[4] Section 1345 (28 U.S.C.) provides:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

tionally be levied on a federal contractor for its possession or use of federal property only if the contractor "derives some beneficial use from its operation and access to the government-owned * * * device" (*id.* at 30a, citing, *e.g.*, *United States* v. *County of Fresno*, 429 U.S. 452 (1977)). The court noted, moreover, that the contractor's use of the government's experimental fusion device was restricted "solely [to the] performance of its contract with the [United States]" (App., *infra*, 31a).

The court nonetheless stated that respondents could constitutionally impose a tax on the contractor's "use" of the government's device because "[w]hat [General Atomics] gains and indeed sells to other customers is knowledge and expertise in fusion research" (App., *infra*, 31a). Noting that the contractor had earned approximately $176,000 in "consulting fees * * * for its expertise gained through work on the * * * device,"[5] the court concluded that "[t]his expertise is the separate, taxable beneficial use of the * * * device" that justifies imposition of the State's tax on the contractor's use of federal property (*id.* at 31a-32a).

The court stated that "[t]he possessory interest tax [imposed by respondents] reaches only that separate beneficial use of government property that [the

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[5] The "consulting fees" to which the court referred (a total of $176,000 earned over several years) represent only 0.04% of the contractor's total revenues during that period (CR 38, at 2-6 (Overskie Decl.)). The taxes, penalties and interest imposed by respondents over this same period ($1,300,000) exceed by several magnitudes the "consulting fees" that the court held to be the constitutional basis for imposition of the state tax on the contractor's "beneficial use" of federal property.

contractor] enjoys; it is not a tax on the property itself" (App., *infra*, 33a). The court did not dispute that a state tax is unconstitutional if it fails "to segregate the contractor's benefit from the value of the government property itself" (*id.* at 34a, citing *United States* v. *Colorado*, 460 F. Supp. 1184 (D. Colo. 1978), aff'd, 627 F.2d 217 (10th Cir. 1980), aff'd *sub nom. Jefferson County* v. *United States*, 450 U.S. 901 (1981)). The court stated, however, that it would not address that issue because the United States had not challenged the assessment on that basis in the briefing on the motion before it (App., *infra*, 34a, 43a).

The United States regarded the question whether the state tax "segregate[d] the contractor's benefit from the value of the government property itself" (App., *infra*, 34a) to be part of its challenge to respondents' "valuation" of the taxable property. See page 10, *supra*. The court deferred to a later proceeding the objections of the United States to respondents' "valuation" of the contractor's "possessory interest" (App., *infra*, 43a).

b. On an interlocutory appeal, the court of appeals affirmed (App., *infra*, 11a-26a). The court first held that, "although the tax levied against General Atomics is nominally an *ad valorem property* tax, General Atomics' use of government-owned improvements lies within California's expansive definition of possessory interest" and is therefore subject to tax under state law (*id.* at 15a).

Having determined that the tax complied with state law, the court then rejected the constitutional objections of the United States. The court noted that, in *United States* v. *Nye County*, 938 F.2d 1040 (9th Cir. 1991), cert. denied, 503 U.S. 919 (1992),

the court previously had held that a State may not constitutionally tax federal property in the hands of a federal contractor if, by doing so, the State "imposes an *ad valorem* tax on property of the government, rather than the contractor's separate private interest in the property" (App., *infra*, 15a). The court held that *Nye County* was inapplicable to the present case because California "taxes only General Atomics' possessory use interest in the device, and not the underlying value of the device itself" (*id.* at 16a).

The court described the private, beneficial use by the contractor of the government's experimental fusion device as "[t]he information and expertise General Atomics obtains through operation of the device [which] enables it to profit by providing information and services to the fusion technology market" (App., *infra*, 22a). The court reasoned that the "valuable knowledge" and the "information and expertise" (*id.* at 18a, 22a) that accrue to General Atomics from its performance of its contractual duties provide a valid basis for the State to impose a tax on the contractor for its "use" of federal property (*id.* at 22a). The court concluded that (*id.* at 20a):

> Because the County seeks to tax only General Atomics' use of the property, and not the property's value, it is not an unconstitutional tax on the United States.

The court of appeals then remanded the case for further proceedings on the "reserved" issue of the proper valuation of the tax (*id.* at 14a).

4. a. On remand, the United States sought to challenge respondents' valuation of the contractor's asserted "possessory interest" in the property. In

particular, the government contended that here, as in *United States* v. *Colorado*, 460 F. Supp. 1184 (D. Colo. 1978), aff'd, 627 F.2d 217 (10th Cir. 1980), aff'd *sub nom. Jefferson County* v. *United States*, 450 U.S. 901 (1981), the *ad valorem* property tax assessment against the federal contractor is unconstitutional because it improperly taxes a value that exceeds any possessory interest of the contractor in the federal property and, instead, taxes the value of the federal property itself.[6] The United States also sought leave to amend its complaint to contend that, in applying an *ad valorem* property tax to federal contractors for their "beneficial use" of property of the United States, the state tax unconstitutionally discriminates against the United States (App., *infra*, 7a-8a).[7]

The district court denied the government's motion for leave to amend without explanation. Then, relying on this Court's recent decision in *United States* v. *California*, 113 S. Ct. 1784 (1993), the court dis-

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[6] In support of this contention, the United States submitted expert appraisal evidence "that the tax assessments in question are imposed upon values in excess of any possible interest of the federal contractor herein and thus are necessarily imposed upon property of the United States" (CR 88 (Mem. of the United States, attaching Steele Decl. at 2)).

[7] The government's claim of discrimination is based on the fact that the State does not generally apply its *ad valorem* property tax to other persons who make a "beneficial use" of "land and improvements" or other "property" owned by third persons. For example, it does not appear that the State taxes university professors for the value of their "beneficial use" of university-owned offices and laboratory equipment that are placed in their "possession" and which they manage in the course of obtaining commercially "valuable knowledge."

missed the remaining "valuation" issues in the case. The court stated that the challenge of the United States to respondents' "valuation methodology does not raise a constitutional issue" and that "there is no other federal cause of action under which the [United States] may challenge the valuation methodology used by the county" (App., *infra*, 46a). The court concluded that any objections of the United States to respondents' valuation of the contractor's interest in the federal property therefore arise only "under state law" (*ibid.*).

The court then explained that, under this Court's decision in *United States* v. *California*, *supra*, the United States could pursue a state-law challenge to respondents' valuation methodology only upon compliance with the state-law prerequisites to a state-law cause of action for a refund. Because the United States and General Atomics had not filed a refund claim with the State or followed any of the other state-law prerequisites to a state-law refund suit, the court dismissed the "valuation" claim asserted by the United States (App., *infra*, 47a-48a).

b. The court of appeals affirmed (App., *infra*, 1a-10a). The court reiterated its earlier conclusion that, under state law, General Atomics had a "taxable possessory interest" in the government's property "because of its *exclusive* and *independent* use of the nuclear device" (*id.* at 4a).[8] The court then rejected

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[8] The evidence reflects that the right to exclude others (including General Atomics) from any use of the device belonged exclusively to the United States (App., *infra*, 28a). The evidence also reflects that General Atomics did not have any right to make any "independent" use of the device (*ibid.*).

The court of appeals acknowledged that its earlier opinion had erred in suggesting that the "possessory interest" of

the government's claim that the state tax was unconstitutional because it failed to segregate the value of the contractor's "possessory interest" in the fusion device from property values belonging wholly to the United States. Relying on this Court's decision in *United States* v. *City of Detroit*, 355 U.S. 466 (1958), the court stated that "[i]t is not unconstitutional for the County to calculate the value of General Atomics' possessory interest by turning to the value of the nuclear device" (App., *infra*, 9a). The court further noted that the United States was barred from any state-law challenge to respondents' "valuation" of the contractor's taxable property interest because neither the United States nor its contractor had complied with the state-law requirements for a state-law refund suit (*ibid.*, citing *United States* v. *California*, 113 S. Ct. at 1790-1791).

Finally, the court of appeals held that the district court did not abuse its discretion in denying the United States leave to amend its complaint to raise the discrimination issue (App., *infra*, 8a). Even though there was no evidence on this issue in the

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General Atomics was in the nature of a taxable "license" under California law (App., *infra*, 5a n.3). The court stated, however, that the fusion device nonetheless constituted an "improvement" because the device was in the nature of a "fixture" that was annexed to the contractor's laboratory "through gravity" (*id.* at 6a). In describing the device as a "fixture" for purposes of the state tax, the court stated that it was "irrelevant" that the device consisted of numerous subassemblies and was capable of (indeed, designed specifically for) disassembly and removal (*id.* at 6a-7a). The court also stated that it was "irrelevant" that the "parties themselves * * * intended the device to remain the personal property of the United States, as evidenced by their contract" (*id.* at 7a).

record of the case (because the district court had not allowed the amended complaint to be filed), the court of appeals asserted that there was "no merit to the United States' contention that General Atomics, unlike similarly situated contractors, is being taxed solely on the basis of the fee and experience that it acquires" (*ibid.*). The court stated that "even though the possessory interest is valuable because of the fee and experience General Atomics reaps, the tax is based on the possessory interest itself, as it is in the case of others similarly situated" (*ibid.*).

REASONS FOR GRANTING THE PETITION

This case presents two important, recurring questions that implicate the fundamental, constitutional relationship of the United States and the States.

The States may not, of course, directly tax property of the United States. May the States, however, tax the property of the United States by imposing a "property" tax on a private contractor for its "possession" of federal property when the contractor is permitted only to manage the property and is not permitted to use it for any commercial purpose? Secondly, if such a "property" tax is constitutionally permissible on the theory that the contractor has a "beneficial use" of the property from the "knowledge" it obtains in managing the property for the United States, may the States value the tax by reference to the value of the federal property—a value that is unrelated to the value of the "knowledge" the private contractor obtains? By concluding that the State may annually tax federal contractors for a portion of the value of federal property that the contractor simply operates and manages, the court of appeals has erroneously narrowed the immunity of

the United States from state taxation and has departed from the decisions of this Court and of other courts of appeals.

The questions addressed in the present case are important and recurring ones. Many valuable properties of the United States are operated and managed by private contractors. Several billions of dollars worth of federal properties are privately operated under federal management contracts in California alone. As a result, there is a significant administrative interest in the prompt resolution of the questions presented in this case.

1. a. In *United States* v. *New Mexico*, 455 U.S. 720 (1982), the Court sought to explain and synthesize the doctrine of federal immunity from state taxation. Reviewing the "inconsistent decisions and excessively delicate distinctions" in this "often confused field" (*id.* at 730, quoting *United States* v. *City of Detroit*, 355 U.S. 466, 473 (1958)), the Court concluded that it should "return to the underlying constitutional principle" (455 U.S. at 733):

> The one constant here, of course, is simple enough to express: a State may not, consistent with the Supremacy Clause, U.S. Const., Art. VI, cl. 2, lay a tax "directly upon the United States." *Mayo* v. *United States*, 319 U.S. 441, 447 (1943). * * * [T]he Court has never questioned the propriety of absolute federal immunity from state taxation.

As the Court stated in *New Mexico*, however, a "more complex problem" arises when a State does not purport to tax the United States itself but instead purports to tax a federal contractor for its "beneficial use of the [federal] property involved." 455

U.S. at 741. The Court noted that a tax on the contractor's "beneficial use" of federal property has not been "seen as falling on the United States" because, "in that situation, the property is being used in furtherance of the contractor's essentially independent commercial enterprise." *Id.* at 742. As the Court explained in *United States* v. *County of Fresno*, 429 U.S. 452 (1977):

> [A] State may, in effect, raise revenues on the basis of property owned by the United States as long as that property is being used by a private citizen or corporation and so long as it is the possession or use by the private citizen that is being taxed.

Id. at 462, citing *City of Detroit* v. *Murray Corp. of America*, 355 U.S. 489 (1958); *United States* v. *City of Detroit*, *supra*; *United States* v. *Township of Muskegon*, 355 U.S. 484 (1958); *Esso Standard Oil Co.* v. *Evans*, 345 U.S. 495 (1953). See also 429 U.S. at 467, quoting *United States* v. *County of Allegheny*, 322 U.S. 174, 187-188 (1944):

> Actual possession and custody of Government property nearly always are in someone who is not himself the Government but acts in its behalf and for its purposes. . . . His personal advantages from the relationship by way of salary, profit or *beneficial personal use* of the property may be taxed as we have held.

A federal contractor may derive a taxable "profit," but it does not derive a "beneficial personal use," from the mere possession and management of property owned by the United States. Indeed, a federal contractor who merely manages federal property, and who is not allowed to "use" the property in com-

mercial activities (as the contractors were allowed to do in *United States* v. *City of Detroit*, 355 U.S. at 468, and *City of Detroit* v. *Murray Corp.*, 355 U.S. at 491), has no right of "personal use" of the property at all.

The Court has made clear that "[t]he vital thing" in determining whether a taxable beneficial use exists is whether the federal contractor is "using the property in connection with its own commercial activities." *United States* v. *Township of Muskegon*, 355 U.S. at 486, quoted with approval in *United States* v. *New Mexico*, 455 U.S. at 739, and *United States* v. *Boyd*, 378 U.S. 39, 45 (1964). That "vital" connection is lacking when, as in the present case, the contractor only manages the property and is not permitted any commercial use of it. A state *ad valorem* property tax that is assessed on a contractor who merely manages federal property unconstitutionally falls on property values belonging solely to the United States. *United States* v. *Colorado*, 627 F.2d 217, 221 (10th Cir. 1980), aff'd *sub nom. Jefferson County* v. *United States*, 450 U.S. 901 (1981).

b. The court of appeals departed from these authorities in this case. The court held that a private contractor who manages federal property has a taxable "beneficial personal use" of that property merely because the contractor may acquire "valuable knowledge" or "expertise" from its work for the government (App., *infra*, 18a, 20a, 22a). The court's rationale evidently creates an exception that swallows the rule, for almost any contractor could be said to gain "valuable knowledge" or "expertise" in the course of managing government property. Moreover, the court's rationale lacks logical substance, for the acquisition of knowledge and experience is not a

species of taxable "property" (or even of taxable "income").

The decision of the court of appeals dramatically departs from the decisions of this Court and of other circuits. As this Court stated in *United States* v. *County of Fresno*, 429 U.S. at 466 n.15, the rationale for a tax on a private party's "beneficial personal use" of governmental property does not apply when the property is "used *only* in performing his job" for the government. A contractor who manages federal property, and who has no right to use the property in "commercial activities" (*United States* v. *Township of Muskegon*, 355 U.S. at 486), *has* no "personal use" of that property to which the State's tax constitutionally could apply.

The decision in this case specifically conflicts with the decision of the Tenth Circuit in *United States* v. *Colorado*, *supra*, which this Court affirmed, 450 U.S. 901 (1981). In *United States* v. *Colorado*, as in the present case, a State attempted to tax a federal contractor for its "possessory interest" in property owned by the United States. The federal contractor in that case, as in the present case, was responsible for the management and operation of the government's property and had no right to use the property in its own commercial activities. The court held that, when the contractor "is merely performing its contractual obligations on government owned property," it cannot be said that the contractor is "using" the government's property (627 F.2d at 220).[9] Because,

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[9] *United States* v. *Anderson County*, 761 F.2d 1169 (6th Cir. 1985), involved a similar effort by a State to impose a "property" tax on a federal contractor whose only interest in federal property was in "performing its duties under [its]

in this context, "the efforts of the State of Colorado to impose a tax on [the federal contractor for its 'possession' of federal property] in reality [imposed] a tax on the property itself," the court held that the state tax was "barred under the doctrine of implied immunity." *Id.* at 219.[10] The court explained that the tax was invalid because, in "substance," the State did not tax a " 'use' of government owned property" but instead applied its "ad valorem general property tax on property owned by the United States." *Id.* at 221.[11] That is precisely the situation here.

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management contract" with the Department of Energy. *Id.* at 1171. Application of the property tax on the contractor's "use" of the federal property was invalidated in that case. The court concluded that the Tennessee tax did not extend to the contractor's claimed interest in the property. In so holding, the court reasoned that a contractor who manages federal property owns no interest in the government property that is "separate from the ownership of the United States." *Id.* at 1174.

[10] In *United States* v. *Colorado*, 627 F.2d at 219-220, the court noted that decisions such as *United States* v. *City of Detroit*, *supra*, allow the States to tax federal contractors for their use of federal property—such as plants, warehouses and machinery—that is used by the contractor in producing commercial products for sale.

[11] In the present case, the court of appeals attempted to distinguish *United States* v. *Colorado* by asserting that the flaw in the State's scheme in that case was that it "taxed the value of the federal property, rather than a segregated interest in the property based on its use" (App., *infra*, 20a). That purported distinction is not correct. In *Colorado*, the court concluded that a contractor who merely performs "management services" on federal property cannot constitutionally be assessed a tax "on property owned by the United States" (627 F.2d at 219). Nothing in *Colorado* suggested that some *smaller* amount of tax would be permissible when,

The decision of the court of appeals in this case also conflicts with that court's prior decision in *United States* v. *Nye County*, 938 F.2d 1040 (9th Cir. 1991), cert. denied, 503 U.S. 919 (1992). In *Nye County*, the court held that a federal contractor who managed federal property could not be taxed for its "possessory interest" in government property because "the property belongs to the United States." 938 F.2d at 1043. Although the court stated that a separate tax might be able to reach the "beneficial use," if any, of the contractor in such property, the court concluded that "an *ad valorem* tax on property of the United States," assessed merely because it is in the hands of a private contractor, "is unconstitutional." *Ibid.*[12]

The "vital thing" in all of these cases is that a federal contractor who is engaged by the United States to manage federal property is not "using the property in connection with its own commercial activities" (*United States* v. *Township of Muskegon*, 355 U.S. at 486). Instead, the contractor is using the government's property "*only* in performing [its] job" (*United States* v. *County of Fresno*, 429 U.S. at 466

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as in that case, the contractor managed the government's property and had no right to use that property in its own commercial activities.

[12] The court of appeals erred in relying (App., *infra*, 17a-19a) on *United States* v. *Boyd*, *supra*, and *United States* v. *New Mexico*, *supra*, for the proposition that a federal contractor who manages federal property may be taxed for its "possession" of that property. Those cases involved gross receipt and sales taxes. See 455 U.S. at 738-744; 378 U.S. at 43. Neither of those cases concerned the question whether a State may apply an annual *ad valorem* property tax to a federal contractor merely for its managerial "possession" of property owned by the United States.

n.15). A state property tax imposed on a contractor who manages federal property is imposed on property values belonging solely to the United States and is therefore unconstitutional. *United States* v. *Colorado*, 627 F.2d at 211.

2. In assessing the tax in this case, respondents valued the "possessory interest" of General Atomics as if it were a 30% interest in a five-year lease on the government's experimental fusion device. See page 5 and note 3, *supra*. That valuation led to assessments of tax, penalties and interest for the years involved of approximately $1,300,000. See page 5, *supra*. The court of appeals concluded that such a tax on the contractor's "beneficial personal use" of the fusion device is justified by the "valuable knowledge" and "expertise" that the contractor derived from its government work (App., *infra*, 18a, 22a). The court noted that the contractor used its expertise in obtaining other consulting work (*id.* at 22a; see *id.* at 32a) which generated (taxable) fees to General Atomics of $176,000. See page 9 & note 5, *supra*.

The valuation methodology applied by respondents is constitutionally flawed.[13] Even when a contractor obtains a "beneficial personal use" from its use of government property, "a contractor may not be taxed beyond the value of his use." *United States* v. *Hawkins County*, 859 F.2d 20, 23 (6th Cir. 1988). In this case, as in *Hawkins County*, the state tax is

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[13] The court of appeals correctly recognized that the United States may challenge the constitutionality of respondents' valuation methodology in this proceeding (App., *infra*, 8a-9a) even if a challenge to the valuation "on state law grounds" would be barred by failure to comply with the state-law prerequisites to a state-law refund suit (*id.* at 9a-10a, citing *United States* v. *California*, 113 S. Ct. at 1790-1791).

invalid because, even if a "beneficial use" occurred, the tax is assessed on the value of the government's property—a value that is entirely unrelated to, and much greater than, the value of the claimed "use."

The court of appeals recognized that the proper method of valuation presents a constitutional issue, for a tax on property values belonging to the United States would effect "an unconstitutional taxation on federal property" (App., *infra*, 9a). The court of appeals asserted, however, that, in *United States* v. *City of Detroit*, 355 U.S. at 470, this Court broadly sanctioned the valuation of any "beneficial personal use" of government property by reference to the value of the government's property itself. The court reasoned that an assessment made "by turning to the value of the nuclear device" was therefore necessarily constitutional (App., *infra*, 9a).

When, as in *United States* v. *City of Detroit*, 355 U.S. at 468, a contractor is using federal property such as plants and machinery in a "private manufacturing business" to produce products for commercial sale, the contractor's interest may be measured by reference "to the value of the property used" (*id.* at 470). This Court has consistently recognized, however, that a state assessment for the "use" of federal property by a federal contractor must conform to the reality of the contractor's "use"; when the contractor's "use" of the property is limited, the value assigned to that "use" must be "severed from" the value of the property belonging to the government (*United States* v. *County of Fresno*, 429 U.S. at 466). Otherwise, what purports to be a permissible tax on the contractor's private use of government property is in fact an impermissible tax on property

values that belong wholly to the United States.[14] The court of appeals therefore erred in relying on *United States* v. *City of Detroit* for the broad proposition that any tax based upon a contractor's "beneficial use" of federal property should be upheld if it is valued "by turning to the value of the [federal property]" (App., *infra*, 9a). In reaching that conclusion, the court of appeals departed from the decision of this Court in *United States* v. *County of Allegheny*, 322 U.S. at 187, and of the Sixth Circuit in *United States* v. *Hawkins County*, 859 F.2d at 23. See also *United States* v. *Colorado*, 627 F.2d at 221.

The tax respondents assessed is not confined to the limited "beneficial personal use" identified by the court of appeals. Respondents' assessment is based on the theory that the federal contractor possessed a 30% interest in a five-year leasehold to use the property for its own commercial purposes. See note 3, *supra*. But the contractor plainly did not possess such an interest. Indeed, the contractor had no right at all to use the fusion device in any commercial activity; it had only the duty to manage the use of the device for the government. See page 4, *supra*.

Moreover, the resulting tax that respondents assessed bears no relationship to the value of the incidental "beneficial personal use" that the court of

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[14] In *United States* v. *County of Allegheny*, 322 U.S. at 187, Justice Jackson wrote for the Court that:

> We have held that where private interests in property were so preponderant that all the Government held was a naked title and a nominal interest, the whole value was taxable to the equitable owner. * * * But that is not the situation here, and the State has made no effort to segregate [the contractor's] interest and tax it.

appeals described. The tax exceeds by several times the total economic benefits ($176,000) that the contractor assertedly derived from the "knowledge" and "expertise" resulting from its management and operation of the government's property. Because the tax assessed by respondents does not meaningfully "sever" or "segregate" the value of the alleged "beneficial personal use" from the value of the property itself, the tax unconstitutionally falls on property values belonging solely to the United States. See *United States* v. *County of Allegheny*, 322 U.S. at 187; *United States* v. *Hawkins County*, 859 F.2d at 23.

3. The questions presented in this case are of substantial recurring importance. The expansive rationale adopted by the court of appeals could be applied to make essentially all property of the United States that is placed in the custody of federal contractors subject to annual state *ad valorem* taxes. There is no obvious basis for distinguishing the "valuable knowledge" and "expertise" gained by the manager of an experimental fusion device from the "valuable knowledge" and "expertise" gained by a federal contractor (or federal employee)[15] who has custody or "possession" of other types of federal property. The extraordinarily broad potential consequences of the reasoning of the court of appeals threatens significantly to alter the historical im-

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[15] In *United States* v. *County of Fresno*, 429 U.S. at 462, 467, the Court upheld application of a state *ad valorem* tax on federal employees who have "possessory interests" in federal property from which they obtain a "beneficial personal use." The significance of the decision of the court of appeals in the present case is therefore not necessarily restricted to property in the possession of federal contractors.

munity of the United States from taxation by the States.

The value of federal property, fixtures and improvements located in the Ninth Circuit that is managed by federal contractors is enormous. We are advised that three of the government's many agencies (the Department of Energy, NASA and the Department of Defense) have property managed by contractors in California alone that exceeds $6.6 billion in value. It is obvious that the federal property managed by (or in the "possession" of) federal contractors throughout the entire Nation has an immense value. An annual tax on even a portion of the value of such property—assessed and collected by the States through assessments against contractors (or employees) who derive "valuable knowledge" and "expertise" from their "use" of federal property—would meaningfully disturb the "absolute federal immunity from state taxation" that this Court has long recognized (*United States* v. *New Mexico*, 455 U.S. at 733).

The decision in this case has particular importance in an era when the federal government is increasingly being asked to turn to private management of its properties. In the constant evolution of government, the proper scope of the immunity of the United States from state taxation is not a hoary irrelevancy. It is, instead, a practical issue of vital and recurring importance under our constitutional scheme of government. See *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819) (Marshall, C.J.).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JULY 1995

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 93-56650

D.C. No. CV-89-00085-RCM

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLANT

v.

COUNTY OF SAN DIEGO, ET AL.,
DEFENDANTS-APPELLEES

Appeal from the United States District Court
for the Southern District of California
Roger C. McKee, Magistrate Judge, Presiding

Argued and Submitted
April 7, 1995—Pasadena, California

Filed April 24, 1995

Before: DOROTHY W. NELSON and
WILLIAM C. CANBY, JR., Circuit Judges,
and JACK E. TANNER,* District Judge

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* Honorable Jack E. Tanner, Senior United States District Judge for the Western District of Washington, sitting by designation.

OPINION

CANBY, Circuit Judge:

The United States appeals the district court's grant of summary judgment in favor of the County of San Diego. We review *de novo* the district court's grant of summary judgment. *Atwood v. Newmont Gold Co.*, 45 F.3d 1317, 1320 (9th Cir. 1995). We have jurisdiction under 28 U.S.C. § 1291, and we affirm.

I

BACKGROUND

General Atomics, a private scientific research firm, conducts nuclear fusion research for the United States Department of Energy as part of a national program. The research is performed using a large nuclear device [1] that is housed on General Atomics' property. Although General Atomics maintains, operates, and helps with the design of the nuclear device, the device is the personal property of the Department of Energy. The Department of Energy also retains control over access to the nuclear device and the right to terminate General Atomic's contract. In exchange for its services, the government pays General Atomics a sizeable fee. General Atomics also provides, for a fee, information and services to the fusion research technology market.

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[1] In fact, two nuclear devices are the subject of this appeal. One of the devices, the "D-III" was in use from 1978 until 1984 when it was dismantled. The other device, the "D-IIID" was then built and has been in use since 1986. Because there are no relevant differences between these nuclear devices for purposes of this appeal, we will simply refer to them as the "nuclear device" or "device."

After a routine audit conducted for the 1978 and 1979 tax years, the County determined that General Atomics has a possessory interest in the nuclear device subject to California's *ad valorem* tax. *See* Cal. Rev. & Tax. Code §§ 104, 105, 107 (West 1987). Pursuant to its agreement with General Atomics to pay all state and local taxes, the United States paid the *ad valorem* tax for tax years 1978-81 and 1987-88. No tax was assessed in 1986, and no taxes have been paid for any other years. General Atomics has not filed timely refund claims for the years for which it paid taxes.

In 1989, the United States filed a suit challenging the constitutionality of the *ad valorem* tax, the designation of the device as a "fixture," and the valuation method used to compute the tax. The district court granted partial summary judgment in favor of the County, holding that the device is a "fixture" and that the tax is constitutional. We considered in an interlocutory appeal the constitutionality of the tax and whether General Atomics has a possessory interest in the device. *See United States v. County of San Diego*, 965 F.2d 691 (9th Cir. 1992) [hereinafter *San Diego I*]. We held that the tax is constitutional and that General Atomics "has an independent possessory interest in [the nuclear device] subject to California's *ad valorem* tax." *Id.* at 693.

After remand, the United States sought leave to amend its complaint by adding an equal protection challenge to the tax. The district court denied the motion. The County then moved for summary judgment on the remaining issues, which the district court granted. The district court held that no federal constitutional issues remained and that the United

States cannot challenge the disputed taxes on state law grounds because General Atomics has failed to satisfy the necessary conditions precedent.

The United States now appeals from the district court's grant of summary judgment in favor of the County. The United States contends: that this court should reexamine its earlier conclusion that General Atomics has a taxable possessory interest in the device, that the district court erred in holding that the nuclear device is a "fixture," that the district court erred by denying its motion for a leave to amend, and that the district court erred in concluding that the United States cannot now challenge the taxes already imposed on state law grounds.

II

ANALYSIS

A. Law of the Case

In *San Diego I*, 965 F.2d at 697-99, we held that under California law General Atomics has a "taxable possessory interest" in the nuclear device owned by the United States. We are precluded from revisiting this decision by the law of the case doctrine. *See United States v. Caterino*, 29 F.3d 1390, 1395 (9th Cir. 1994). The United States' argument that controlling authority has since made our earlier decision inapplicable is without merit. In *San Diego I* we held that General Atomics has a taxable possessory interest primarily because of its *exclusive* and *independent* use of the nuclear device.[2] *San Diego I*, 965

[2] Under California law, four factors are relevant to whether a taxable possessory interest exists: exclusivity, independ-

F.2d at 697-99. No cases cited by the United States call into question this analysis.[3]

B. Is the Nuclear Device a Fixture?

The United States argues that the district court erred in concluding that the device is a fixture because: the district court erroneously stated that the fixture was bolted down, the device is not one integral device but thousands of replaceable parts, and the parties did not intend the device to be a fixture. Under California law, a device is a fixture if a "reasonable person would consider the item to be a permanent part of the property, taking into account annexation, adaption, and other objective manifestations of permanence." *Crocker Nat'l Bank v. City & County of San Francisco*, 49 Cal. 3d 881, 887-88, 264 Cal. Rptr. 139, 142 (1989). Whether something is a fixture is predominantly a legal question. *Id.* The criteria relevant to whether the nuclear device is a fixture are: "(1) the manner of its annexation to the realty; (2) its adaptability to the use

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ence, durability, and private benefit. *See San Diego I*, 965 F.2d at 697. In the earlier appeal, "[t]he government challenge[d] the district court's ruling on three of these factors: exclusivity, independence, and private benefit." *Id.*

[3] We recognize that our earlier decision may have misparaphrased California law in stating that a license or permit is a taxable possessory interest in property. *San Diego I*, 965 F.2d at 694. *See County of Los Angeles v. Assessment Appeals Bd.*, 13 Cal. App. 4th 102, 112, 16 Cal. Rptr. 2d 479, 485 (1993); *Service America Corp. v. County of San Diego*, 15 Cal. App. 4th 1232, 1238, 19 Cal. Rptr. 2d 165, 169 (1993). This part of our discussion, however, dealt only with the constitutionality of the tax. *See San Diego I*, 965 F.2d at 694. Moreover, we did not rely on a theory of mere license in concluding that the tax is constitutional.

and purpose for which the realty is used; and (3) the intention with which the annexation is made." *Id.* at 887, 264 Cal. Rptr. at 142.

The nuclear device weighs between 400 and 500 tons. A device can be, and in this case clearly is, annexed to the property through gravity. *See Seatrain Terminals of California, Inc. v. County of Alameda*, 83 Cal. App. 3d 69, 75, 147 Cal. Rptr. 578, 582 (1978) ("[T]he mere retention in place by gravity is sufficient to give [certain kinds of heavy machinery] the character of permanency and therefore affixation to realty").

The real estate has also been modified to accommodate the device. Tunnels have been dug and a reinforced concrete flooring has been installed. Thus, the property has been adapted for the device. *See Crocker Nat'l Bank*, 49 Cal. 3d at 887, 264 Cal. Rptr. at 142. General Atomics property is also peculiarly valuable as a nuclear fusion research facility only because of the nuclear device. *See Seatrain*, 83 Cal. App. 3d at 76, 147 Cal. Rptr at 582 (important question to adaptive criterion "is whether the real property is peculiarly valuable because of the continued presence of the annexed property thereon"). In light of applicable criteria, the nuclear device clearly is a fixture.

We find no merit in the contention of the United States that it has raised genuine issues of material fact that preclude summary judgment on whether the device is a fixture. The district court's erroneous statement that the nuclear device was bolted down is of no consequence. The device is annexed to the property by gravity. Although the United States correctly points out that parts of the nuclear device can

be removed, this fact is also irrelevant. Most fixtures, presumably like the cranes in *Seatrain*, consist of removable and replaceable parts.[4] *See Seatrain*, 83 Cal. App. 3d at 75-76, 147 Cal. Rptr. at 582. Finally, although "the intention with which the annexation is made" is relevant to whether the devices are fixtures, "intention" is "determined by the physical facts or reasonably manifested outward appearances . . . ." *See Crocker Nat'l Bank*, 49 Cal. 3d at 887, 782, 264 Cal. Rptr. at 142 (citation omitted). Thus the fact that the parties themselves may have intended the device to remain the personal property of the United States, as evidenced by their contract, is irrelevant.[5]

C. Leave to Amend

The United States sought to amend its complaint by adding a count stating that imposing the tax "solely on the basis that General Atomics acquires

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[4] The United States' characterization of the nuclear device as not one unit, but "thousands of individual components" none of which are "fixtures" is a distinction that does not make a difference. Most fixtures that are affixed to real estate through gravity are made up of replaceable parts. The relevant issue is whether the nuclear device *qua* nuclear device is a fixture.

[5] The California State Board of Equalization's conclusion that the device was not a fixture for sales tax purposes is also irrelevant. Whether the device is a fixture for purposes of the possessory interest tax is independently reviewed. While the Board's reasoning itself might be persuasive in some cases, it is not here. Simply because the Board reached a conclusion different from the district court does not show that there exist any genuine issues of material fact relevant to whether the device is a fixture.

experience and receives a fee by virtue of performing contractual services for the United States . . . unconstitutionally discriminates against the United States and . . . General Atomics . . . ." The district court did not abuse its discretion in denying the leave to amend.[6] There is no merit to the United States' contention that General Atomics, unlike similarly situated contractors, is being taxed solely on the basis of the fee and experience that it acquires. In *San Diego I*, we explicitly held that the County is taxing General Atomics on its possessory interest, which it has because of its "exclusive," "independent," and "durable" interest in the nuclear device. *See San Diego I*, 965 F.2d at 697-98. It is true that in order to tax General Atomics on this possessory interest, this interest must privately benefit General Atomics. *See id.* at 698. But even though the possessory interest is valuable because of the fee and experience General Atomics reaps, the tax is based on the possessory interest itself, as it is in the case of others similarly situated. There is no discrimination. The district court did not abuse its discretion in denying the leave to amend because the amendment would have been futile. *See Sorrosky v. Burroughs*, 826 F.2d 794, 804-05 (9th Cir. 1987).

D. The Method of Valuation

The district court correctly rejected the United States constitutional challenge to the method of valuation. The United States insists that the tax assess-

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[6] We review for an abuse of discretion the district court's denial of the motion for leave to amend the complaint. *National Abortions Fed'n v. Operation Rescue*, 8 F.3d 680, 681 (9th Cir. 1993).

ments are based upon property values wholly owned by the United States and thus amount to an unconstitutional taxation on federal property. It is mistaken. We have already held that the County is taxing General Atomics on *its* possessory interest in the property. *San Diego I*, 965 F.2d 691. It is not unconstitutional for the County to calculate the value of General Atomics' possessory interest by turning to the value of the nuclear device. *United States v. City of Detroit*, 355 U.S. 466, 470 (1958) ("In measuring [a beneficial use] tax [as opposed to a tax on the property itself] it seems neither irregular nor extravagant to resort to the value of the property used").

Finally, the district court correctly concluded that the United States could not now challenge the method of valuation on state law grounds. In order to do so, the government must proceed on a subrogation theory. *See United States v. California*, 113 S.Ct. 1784, 1790-91 (1993). General Atomics has not filed timely refund claims for the years for which it paid taxes, and it has not paid at all for some other years. It thus has not complied with the state law requirements for challenging the method of valuation. *See* Cal. Rev. & Tax. Code § 5142 (West 1987).[7] The United States as subrogee is subject to these preexisting infirmities in General Atomics' claims, and thus cannot now challenge the method of valuation on state law grounds. *See United States v. State of*

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[7] The United States mistakenly asserts that the district court decided that it lacked standing to pursue the claim. The United States has standing to challenge the method of valuation as General Atomics' subrogee.

California, 932 F.2d 1346, 1350-51 (9th Cir. 1991), *aff'd*, 113 S.Ct. 1784 (1993); *United States v. California*, 113 S.Ct. at 1790-91.[8]

III

CONCLUSION

The County of San Diego is properly taxing, both as a matter of constitutional law and California law, General Atomics on its possessory interest in the nuclear device it operates for the Department of Energy.

The district court's grant of summary judgment is AFFIRMED.

AFFIRMED.

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[8] Although the United States may be correct that the statute of limitations has not run on most of its claims, this fact does not permit the government to circumvent the state law requirements for challenging the method of valuation as a subrogee.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 91-55321

D.C. No. CV-89-0085-T(CM)

UNITED STATES OF AMERICA,
PLAINTIFF-APPELLANT

v.

COUNTY OF SAN DIEGO,
DEFENDANT-APPELLEE

Appeal from the United States District Court
for the Southern District of California
Howard B. Turrentine, District Judge, Presiding

Argued and Submitted
February 6, 1992—Pasadena, California
Filed May 19, 1992

Before: J. CLIFFORD WALLACE, Chief Judge, JAMES R. BROWNING and OTTO R. SKOPIL, JR., Circuit Judges

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OPINION

WALLACE, Chief Judge:

The United States of America (government) appeals from a district court decision denying its motion for summary judgment and granting partial summary judgment to the County of San Diego (County). We are presented with the question of whether General Atomics, a federal contractor, has an independent possessory interest in a government-owned experimental fusion device (device) subject to California's *ad valorem* property tax. The district court had jurisdiction pursuant to 28 U.S.C. §§ 1331, 1345. We have jurisdiction over this interlocutory appeal pursuant to 28 U.S.C. § 1292(b). We affirm.

I

The United States Department of Energy (Department) funds and administers nuclear fusion research at several locations throughout the country in an attempt to develop a magnetically confined fusion system capable of generating commercial electric power. *See* Magnetic Fusion Energy Engineering Act of 1980, 42 U.S.C. § 9301(b)(1). General Atomics, a private scientific research firm, maintains and operates a federally owned experimental fusion device at its San Diego facility. Pursuant to seven different cost reimbursement contracts, General Atomics provides services to the government with respect to the design, assembly, operation, and maintenance of the device. The contracts are terminable at the option of the Department. Although located on General Atomics' property, the device remains the personal property of the Department, which retains control

over access to the device by General Atomics' employees and others. The district court determined that the device is a fixture on General Atomics' property, and the government does not appeal that decision.

Pursuant to the contracts, General Atomics participates in long and short range planning for use of the device, subject to the approval of the Department. General Atomics regularly reports to the Department on general progress, as well as on the attainment of specific planning milestones. The Department maintains a permanent on-site representative who monitors and assesses General Atomics' progress by attending planning meetings and reviewing periodic reports. General Atomics' scientists are required to publish the results of the experiments and collaborate with scientists from the United States and foreign countries at the direction of and discretion of the Department.

The government pays General Atomics a fee for its services, averaging approximately $2.5 million per annum over the past seven years. In addition, all allowable costs incurred by General Atomics are reimbursed by the government. The government is also obligated to pay all state and local taxes on the device, including those addressed in this appeal.

The County made its first determination that General Atomics had a taxable possessory interest in the device after conducting a routine audit for the 1978 and 1979 tax years. In total, General Atomics has paid taxes, interest, and penalties, less refunds, in the amount of $568,002.12 for the 1978-81, 1987 and 1988 tax years. Since 1988, General Atomics has received, but has not paid, tax bills for the years 1982-85 and 1989, plus interest and penalties, in the amount of $721,979.55. The district court held that

General Atomics has a taxable possessory interest in the device, but reserved the issue of its valuation pending this appeal. We granted the government's petition to bring this interlocutory appeal.

II

The government argues that the County's levy of an *ad valorem* property tax on General Atomics' use of the device violates the supremacy clause of the United States Constitution. We review the district court's order granting summary judgment de novo. *Winebrenner v. United States*, 924 F.2d 851, 853 (9th Cir. 1991).

A.

We first consider whether the California statute in question constitutionally taxes possessory interests in federally owned property. California authorizes counties to assess and collect *ad valorem* taxes on possessory interests in real property owned by a tax exempt entity and improvements thereon. Cal. Const. art. XIII; Cal. Rev. & Tax. Code §§ 104, 107 (West 1987); Cal. Code Regs. tit. 18, § 21(b) (1990). A possessory interest includes "[p]ossession of, claim to, or right to the possession of land or improvements." Cal. Rev. & Tax. Code § 107(a). The device is a fixture, and therefore qualifies as an "improvement." *See id.* § 105(a). The California courts have defined "possessory interest" as "includ[ing] the right of a private individual or corporation to use government-owned tax exempt land or improvements, and this right is considered a private interest taxable by the state and its taxing agencies." *United States v. County of Fresno*, 50 Cal. App. 3d 633, 638 (1975), *aff'd*, 429 U.S. 452 (1977). In addition, a

license or permit is a taxable possessory interest in property. *See Stadium Concessions, Inc. v. City of Los Angeles*, 60 Cal. App. 3d 215, 222 (1976) (*Stadium Concessions*), *citing Kaiser Co. v. Reid*, 30 Cal. 2d 610, 618 (1947) (*Kaiser*).

General Atomics' right to "use" the device, in the form of a license, is regulated by the terms and procedures contained in the contracts. Therefore, although the tax levied against General Atomics is nominally an *ad valorem property* tax, General Atomics' use of government-owned improvements lies within California's expansive definition of possessory interest. *See United States v. County of Fresno*, 50 Cal. App. 3d at 638.

In *United States v. Nye County, Nevada*, 938 F.2d 1040 (9th Cir. 1991) (*Nye County*), *cert. denied*, 112 S. Ct. 1292 (1992), we held that taxation pursuant to a Nevada statute was unconstitutional because it imposed an *ad valorem* tax on property of the government, rather than the contractor's separate private interest in the property. *Id.* at 1043. We found that because the statute levied a tax on the contractor "in the same amount and to the same extent as though the lessee or user were the owner of the property," Nev. Rev. Stat. § 361.159(1), it made "no attempt to segregate and tax any possessory interest [the contractor] may have in the property." *Nye County*, 938 F.2d at 1043. As such, the statute violated the supremacy clause. In dicta, we affirmed the power of the state to assess a tax on federally owned tax-exempt property used by a contractor, stating that "[w]hile Nye County could no doubt enact a statute taxing a lessee's possessory interest in, or a user's beneficial use of, property owned by

the United States, the statute under which it levied taxes against [the contractor] is not such a tax measure." *Id.*

The California statute does not suffer from the constitutional infirmity found in the Nevada statute. California's *ad valorem* tax statute taxes only General Atomics' possessory use interest in the device, and not the underlying value of the device itself. Therefore, if General Atomics has a possessory interest in the device, that interest may be taxed constitutionally by the California statute.

B.

We now turn to the question whether the County's tax levy in this case violates the supremacy clause of the United States Constitution. The supremacy clause prohibits state taxation of federal property without the consent of the sovereign. *United States v. New Mexico*, 455 U.S. 720, 733 (1982) (*New Mexico*); U.S. Const. art. VI, cl.2. In *United States v. County of Fresno*, 429 U.S. 452 (1977) (*County of Fresno*), California taxed possessory interests in federally owned housing held by federal forest rangers. The Supreme Court declined to invalidate the tax, stating that to the extent a state can isolate a private person's interest in property owned by the government, it can tax that interest. *Id.* at 462. After upholding the tax on a forest ranger's use of federal housing, the Court opined that such a tax would not, however, be permitted on an employee's use of federal property, such as a fire ax or tower, which "he used *only* in performing his job . . . . The employee does not put either the ax or the tower to 'beneficial personal use,' and it is not part of his

'profit' or his 'salary.'" *Id.* at 466 n.15 (emphasis in original) (citation omitted).

The government contends that General Atomics is not subject to taxation because it does not put the device to "personal beneficial use." It makes three related arguments. First, the government likens General Atomics' use of the device to a forest ranger's use of a fire ax. It contends that to have a "beneficial personal use" of federally owned property, an entity must have been granted a right to use the federally owned property in its own discretion to pursue some private purpose, citing *County of Fresno.*

Nothing in *County of Fresno*, however, implies that incidental benefits accruing to General Atomics as a result of its performance of contractual duties cannot also constitute "personal beneficial use." In *County of Fresno*, for example, forest rangers were required to live in federally owned cabins as part of their employment duties. Although the rangers fulfilled contractual obligations by living in the cabins, the Court nonetheless found that the County of Fresno could tax their use of the property because they benefitted personally from the housing. As the rangers received a taxable benefit for use of the cabins, so too did General Atomics' performance of the contracts result in incidental taxable benefits stemming from participation in research directed at producing commercially valuable technical information.

Next, the government contends that General Atomics is a mere business invitee, and that its use of the device is related solely to performance of "service" contracts for the Department. This argument was rejected by the Supreme Court in *United States v. Boyd*, 378 U.S. 39, 44-45 (1964) (*Boyd*). The management contracts in *Boyd* required the con-

tractors to perform maintenance and construction work at federal facilities under the direction of the government. The contractors owned none of the property involved, and received a fixed annual fee for their services. Tennessee levied a use tax on the property. The Court found irrelevant the fact that the property was being used for the government's benefit, stating that the contractors' actions remained "commercial activities carried on for profit." *Id.* at 44.

Similarly, in this case, the annually negotiated fees earned by General Atomics are substantial, and "[n]o one suggests that [General Atomics] has put profit aside in contracting with the [Department]." *Id.* at 45. Receipt of these fees and access to the device enable General Atomics to participate in the field of fusion research, an activity it could not otherwise afford to conduct on its own. General Atomics participates extensively in the planning process and obtains information and expertise by conducting fusion research for the Department. This research differs from mere "service" of federal property in that its very purpose is to obtain valuable knowledge, rather than merely to operate and maintain the device. General Atomics benefits financially from the sale and application of knowledge obtained from experiments conducted with the use of the device. And its participation in determining the nature of the research conducted necessarily involves a level of use exceeding that of a business invitee providing contract services.

In *New Mexico*, the Supreme Court recognized that federal contractors "receive a variety of additional benefits from the[ir] contract[s with the govern-

ment]. Most obviously, they develop expertise and acquire valuable technical information." 455 U.S. at 724 n.3. General Atomics obtains like benefits from its contracts with the Department. Therefore, the County's taxation of this beneficial use is not a tax on federal property, but rather a tax on an "essentially independent commercial enterprise." *Id.* at 742.

The government also argues that General Atomics has no property interest in the device because the contracts expressly prohibit its use for private purposes. That General Atomics is prohibited from using the device for purposes other than performance of contractual duties is irrelevant to our inquiry. Contractual restrictions do not preclude a determination of a taxable beneficial use of property. *See United States v. Township of Muskegon*, 355 U.S. 484, 487 (1958). The government's focus on contractual limitations avoids the essential underlying issue: whether General Atomics makes beneficial use of the device concurrent with its performance of contractual duties for the Department.

The government attempts to distinguish *New Mexico* and *Boyd* on the basis that they addressed sales, gross receipts, and compensating use taxes, and not an *ad valorem* property tax like the one levied against General Atomics. However, because California's possessory interest statute includes taxation for *use* of property, the "use" versus property" distinction urged by the government, and discussed in *Nye County*, is not persuasive here. *United States v. County of Fresno*, 50 Cal. App. 3d at 638; *Nye County*, 938 F.2d at 1042-43. In light of California's interpretation of the *ad valorem* property tax as including use, we are persuaded that the reasoning of

New Mexico and *Boyd* apply equally to the tax levied in this case. Therefore, we affirm the district court determination that General Atomics has a personal beneficial interest in the device.

The cases cited by the government in support of its position are readily distinguishable. The statute in *United States v Colorado*, 627 F.2d 217 (10th Cir. 1980), *aff'd*, 450 U.S. 901 (1981), like the statute in *Nye County*, taxed the value of the federal property, rather than a segregated interest in the property based on its use. *Id.* at 218. Similarly, the court in *United States v. Hawkins County, Tennessee*, 859 F.2d 20 (6th Cir. 1988), *cert. denied*, 109 S.Ct. 1638 (1989), found that the contractor made "beneficial use of the government-owned property" because it earned a profit on its cost-plus contracts, but held that the state statute did not tax such "beneficial use." *Id.* at 23. These cases are inapplicable to the statute addressed here. Finally, the government relies on *United States v. Anderson County, Tennessee*, 761 F.2d 1169 (6th Cir.), *cert. denied*, 474 U.S. 919 (1985), which invalidated a tax because the state supreme court had already held that the contractor did not possess a taxable interest under Tennessee's statute. *Id.* at 1172-75. In contrast, California's statute imposes a tax on General Atomics' separate possessory interest in the device, and no state court has ruled that General Atomics lacks such an interest in the device. Because the County seeks to tax only General Atomics' use of the propery, and not the property's value, it is not an unconstitutional tax on the United States.

C.

We have determined that General Atomics has a possessory interest in the device stemming from its personal beneficial use. The government concedes that General Atomics "benefits from its federal contract by way of its fixed fee and by acquisition of experience." Nonetheless, it argues that General Atomics' use of the device is not taxable because it is conducted at the direction and discretion of the Department, for the sole benefit of the government. Although the government does not argue that General Atomics is its agent, this arguments amounts to the same.

In *New Mexico*, the Supreme Court held that the "underlying constitutional principle" of the supremacy clause is that "a State may not . . . lay a tax 'directly upon the United States.'" 455 U.S. at 733 (citations omittted). *New Mexico* addressed the question: "to what extent may a State impose taxes on contractors that conduct business with the Federal Government?" *Id.* at 722. The Court pointed out that "immunity may not be conferred simply because the tax has an effect on the United States, or even because the Federal Government shoulders the entire burden of the levy." *Id.* at 734. It concluded

> that tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.

Id. at 735.

General Atomics is an independent corporate entity with involvement in fusion research predating its contracts with the government. It brought skill and knowledge to the experiment that the government needed and did not have. Should the Department seek to conduct an experiment with its own employees, it may do so. Having chosen a different path, however, the government cannot persuasively argue that General Atomics' use of the device is such that it should be treated as an instrumentality of the government and thus enjoy immunity from taxation. *See Boyd*, 378 U.S. at 48.

The information and expertise General Atomics obtains through operation of the device enables it to profit by providing information and services to the fusion technology market. Therefore, with respect to the activity being taxed, we agree with the district court that General Atomics' interest in the device sufficiently distinguishes it from the government, such that a tax on General Atomics is not a tax on the government in violation of the supremacy clause.

D.

Finally, we point out that *New Mexico* also fashioned a separation of powers framework for analyzing supremacy clause challenges to state taxation:

> [i]f the immunity of federal contractors is to be expanded beyond its narrow constitutional limits, it is Congress that must take responsibility for the decision, by so expressly providing as respects contracts in a particular form, or contracts under particular programs. And this allocation of responsibility is wholly appropriate, for the political

> process is uniquely adapted to accommodating the competing demands in this area. But absent congressional action, we have emphasized that the States' power to tax can be denied only under the clearest constitutional mandate.

455 U.S. at 737-38 (internal quotations and citations omitted). Thus, *New Mexico* requires courts to construe constitution lilimts on state taxation narrowly. Here, as in *New Mexico*, Congress could have, but did not, bar state and local taxation of the Department's "activities." We therefore will not "establish as a constitutional rule something that [the Department] was unable to obtain statutorily from Congress." *Id.* at 744.

III

The government contends that even if the County's levy of the possessory interest tax does not violate the supremacy clause, General Atomics is not subject to the tax as a matter of California law. The existence of a taxable possessory interest under California law is determined by objective circumstances, rather than the language of the contracts. *Stadium Concessions*, 60 Cal. App. 3d at 223. Four factors are weighed: exclusivity, independence, durability, and private benefit. *See* 18 C.C.R. 21(a)(1); *Freeman v. County of Fresno*, 126 Cal. App. 3d 459, 463 (1981) (*Freeman*); *Stadium Concessions*, 60 Cal. App. 3d at 223. The government challenges the district court's ruling on three of these factors: exclusivity, independence, and private benefit.

A possessory interest must carry "the degree of *exclusiveness* necessary to give the occupier or user something more than a right in common with others."

United States v. County of Fresno, 50 Cal. App. 3d at 638 (emphasis in original). The government argues that because General Atomics cannot exclude the government, or anyone it directs, from using the device, General Atomics' use is not "exclusive."

Exclusivity is broadly defined under California law. *See Stadium Concessions*, 60 Cal. App. 3d at 224. An exclusive use, however, is not destroyed by "multiple," "concurrent," or "alternating" uses of the property. *Id.* Nor is exclusivity affected by the temporary and revocable status of a possessory interest. *Board of Supervisors v. Archer*, 18 Cal. App. 3d 717, 725 (1971) (*Archer*). Contractual conditions that limit General Atomics' use of the device go to valuation, not exclusivity. *Id.; Freeman*, 126 Cal. App. 3d at 465. Therefore, we hold that General Atomics' use of the property is "exclusive" within the meaning of that term because it is not "shared by the general public." *Freeman*, 126 Cal. App. 3d at 463-64; *see also United Air Lines v. County of San Diego*, 2 Cal. Rptr. 2d 212, 217 (Ct. App. 1991) (upholding *ad valorem* property tax on airline's use of municipal airport runway).

The government also contends that General Atomics' use of the device is not "independent" because it manages the device at the direction of the government for the government, not for private business purposes. A use is independent, however, when "much is left to the routine control and supervision of the [user]" even though the government retains "ultimate control." *Stadium Concessions*, 60 Cal. App. 3d at 225. General Atomics participates in both the broad and detailed stages of planning and alone operates the device. Hundreds of General Atomics' employees perform

nearly all functions under the contracts. Routine control is exercised by General Atomics. Though the government retains ultimate control over the device, this fact bears upon only the value of General Atomics' interest, not its taxability. *See Freeman*, 126 Cal. App. 3d at 465; *Archer*, 18 Cal. App. 3d at 725.

In arguing a lack of private benefit, the government contends that the "acquisition of experience that the District Court determined . . . to constitute the taxable private benefit does not give [General Atomics] an interest in the property subject to the possessory interest use tax." It relies on *Kaiser* for the proposition that a tangible possessory interest is a "usufructuary right, that is, the right of using and enjoying the profits of a thing belonging to another, without impairing the substance." 30 Cal. 2d at 621 (internal quotations omitted). The government contends that General Atomics is a mere business invitee serving the purposes of the Department, rather than any private business interest.

California law allows taxation of an interest in government property if the "possession" or "use" of the property privately benefits the user. *Cox Cable San Diego, Inc. v. County of San Diego*, 185 Cal. App. 3d 368, 381 (1986). *Cox Cable* defines private benefit as "the right to obtain an economic benefit from the use or possession of property." *Id.* This right includes use of tax exempt property under government control. *Id.* General Atomics receives a fee for managing the device, as well as substantial saleable expertise. The fact that General Atomics' activities fulfill contract obligations to the government does not negate the fact that General Atomics also obtains an economic benefit from its use of the device.

In conclusion, we point out that in recent years, California courts have applied the possessory interest factors

> "in a less demanding way so as to find a taxable interest in most cases in which the private use of public property has been special to the person concerned and valuable . . . [T]he focus has been on the belief that the holder of a valuable use of public property that is tax exempt should contribute taxes to the public entity which makes its possession possible and provides a certain amount of exclusivity."

Id. at 382, *quoting Freeman*, 126 Cal. App. 3a at 463 (emphasis deleted). In accord with this trend in California law, we conclude that General Atomics' interest in the fusion device is taxable by the California statute.

AFFIRMED.

APPENDIX C

[Filed Jun. 25, 1990]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case 89-0085-T (CM)

UNITED STATES OF AMERICA, ET AL., PLAINTIFFS

v.

COUNTY OF SAN DIEGO, ET AL., DEFENDANTS

OPINION AND ORDER

I. FACTS.

The United States Department of Energy ("U.S.") funds and administers nuclear fusion research and development at several facilities throughout the country, including Lawrence Livermore Laboratory, Princeton University, and the General Atomics ("GA") research facility in San Diego, California. The goal of this research is to develop nuclear fusion into a commercially viable means of energy production.

At issue in this case is an attempt by the County of San Diego ("the County") to impose a possessory interest tax on GA's use of an experimental fusion

research device which is owned by the U.S. The assessments were levied on GA's possessory interest in the Doublet DIII and DIIID experimental nuclear fusion devices ("the Doublet device"), located on GA-owned real property at GA's San Diego research facility.[1]

The Doublet device is a doughnut-shaped magnetic plasma accelerator, which weighs 400-500 tons and is surrounded by a vast network of cooling, ventilation, and power equipment. The U.S. funded and owns the Doublet device, which was designed and constructed by GA under contract with the U.S. The U.S. also engaged GA to administer and operate the Doublet device, in conjunction with other scientists from the U.S. and foreign countries, at the discretion and direction of the U.S. Under the cost-plus fee contract with GA, the U.S. retains ownership and complete ultimate authority over the use of the device. The U.S. is also contractually obligated to pay all state and local taxes on the device.

The County levied a tax assessment on GA's possessory interest in the Doublet device, which led to this lawsuit. The U.S. seeks to have the tax declared unconstitutional and seeks an injunction against the County prohibiting it from assessing or collecting on its prior assessments. Both parties now move for summary judgment.

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[1] The DIII device was in operation from 1978-1984; the DIIID device has been in operation since 1986. The Doublet DIII/DIIID device is a larger, improved version of the Doublet DI and II devices, which were invented and funded by GA years ago.

II. DISCUSSION.

This "possessory interest tax" was imposed pursuant to Cal. Rev. & Tax. Code § 107 (West 1987).[2] The U.S. argues that this tax violates the supremacy clause of the U.S. Constitution because GA has been granted no taxable possessory interest in the U.S.-owned device. Thus, the U.S. argues, this tax is not a tax on GA, but rather an unconstitutional tax on the Federal Government's property.

The County counters that GA has a taxable beneficial use of the device, which is taxable under California law as a fixture to GA's realty. The County also asserts that this court has no jurisdiction to resolve the question of whether GA's possessory interest was properly valued.

Thus, the issues before the court are: 1) whether GA has a taxable beneficial use of the Doublet device; 2) whether that beneficial use is a possessory interest in real property under California law; 3) whether the device is an improvement to realty under California law; and, 4) whether this court has jurisdiction to resolve the question over the valuation of GA's beneficial interest in the device.

A. THE SUPREMACY CLAUSE.

The U.S. argues that the County's tax is barred by the supremacy clause of the U.S. Constitution, because it is a state tax on Federal Government's

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[2] Cal. Rev. & Tax. Code § 107 defines "possessory interests" as

> (a) Possession of, claim to, or right to the possession of land or improvments, except when coupled with ownership of the land or improvements in the same person.
>
> (b) Taxable improvements on tax-exemp land.

property, prohibited by *McCulluch v. Maryland*, 4 Wheat. 316 (1819). While *McCulluch* does proscribe state taxes on federal property, subsequent cases have held that a state may permissibly tax federal property in the hands of a private party, so long as the private party has some sort of independent beneficial interest in the property. *See, e.g., United States v. County of Fresno*, 429 U.S. 452 (1977); *United States v. New Mexico*, 455 U.S. 720 (1982); *United States v. Boyd*, 378 U.S. 39 (1864); *United States v. City of Detroit*, 355 U.S. 466 (1958).

The rule was most recently stated in *Fresno*, where the Court stated, "a State may . . . raise revenues on the basis of property owned by the United States as long as that property is being used by a private citizen or corporation and so long as it is the possession or use by the private citizen that is being taxed." 429 U.S. at 462.[3] Examples of such taxable beneficial uses are profits or salaries derived from the use of the federal property. *Id.* at 466 n.15 (citing *United States v. City of Detroit, supra*, 355 U.S. at 471). A tax on such a use is permissible even if the Federal Government is contractually obligated to pay the tax, as the U.S. is here. *United States v. Boyd*, 378 U.S. 39, 44 (1963). Thus, the question presented is whether GA derives some beneficial use from its operation and access to the government-owned Doublet device.

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[3] A state may tax a private party's beneficial use or possession of federal property so long as that tax does not discriminate against the federal government. *See Fresno, supra*, 429 U.S. at 462. There is no contention here that the County's ta xis discriminatory. The only issue is whether GA has a taxable beneficial interest in the Doublet device.

In *Fresno*, the Court found a beneficial use in U.S. Park rangers' residence in government-owned housing. The rangers were required to live in the federally owned houses and the Forest Service deducted from the rangers' pay an amount estimated as the fair rental value of this housing. The County of Fresno imposed a possessory interest tax on the rangers, calculating the taxable amount of the possessory interest as the fair rental value of the housing as well. The Court upheld the tax on the rangers' possessory interests in the houses, since the rangers derived a beneficial personal use from the housing. Thus, the Court concluded, "the 'legal incidence' of the tax . . . falls neither on the Federal Government nor on federal property. The tax is imposed solely on private citizens who work for the Federal Government." *Id.* at 464.

The Court distinguished a ranger's personal benefit in free housing from a ranger's use of a fire ax or a fire tower, stating that such tools would be used solely in the performance of the ranger's job, thus conferring on him no separate, taxable benefit. 429 U.S. at 466 n.15.

Here, the U.S. equates GA's use of the Doublet device with the ranger's use of a fire ax. GA's management of, and experimentation with the Doublet device are performed solely in GA's performance of its contract with the U.S. Thus, the U.S. argues, GA obtains no separate benefit from its use of the device. This conclusion is clearly incorrect.

What GA gains and indeed sells to other customers is knowledge and expertise in fusion research. The deposition testimony of GA personnel quantifiies consulting fees earned by GA for its expertise gained

through work on the Doublet device. GA scientists publish papers detailing their findings from work on the device, and GA has sold its expertise gained through work on the device to various customers, including the U.S. and foreign governments. This expertise is the separate, taxable beneficial use of the Doublet device enjoyed by FA.

Similarly, in *United States v. New Mexico*, 455 U.S. 720 (1982), the Court found a taxable beneficial use in a Department of Energy contractor, Sandia, which managed the government owned Sandia Laboratories and engaged in federally sponsored research there. After discussing the contractual fee received by Sandia, the Court noted, "Sandia and its parent receive a variety of additional benefits from the contract. Most obviously, they develop expertise and acquire valuable technical information." *Id.* at 724 n.3. In upholding a tax on Sandia's use of federal property in performance of its contracts, the Court again noted that Sandia "obtains obvious benefits from its contractual relationship with the United States." *Id.* at 740 n.13. "[I]n that situation, the property is being used in furtherance of the contractor's essentially independent commercial enterprise." *Id.* at 742.

Here, GA similarly obtains the benefit of expertise and technical information in fusion research from its performance of its contract with the U.S. The County's taxation on this benefit is not a tax on federal property, but a tax on GA's "essentially independent commercial enterprise." *Id.*

By arguing that GA's use of the device is solely at Department of Energy discretion, the U.S. asserts that GA is therefore really an agent of the

government. This very argument was rejected in *New Mexico* and *Boyd*. In *Boyd*, Union Carbide was held to have received a beneficial use through its management and operation of the Department of Energy's Oak Ridge nuclear plant. 378 U.S. at 48. "Of course there are governmental directives and instructions which must be obeyed [by Union Carbide] . . . . But Carbide . . . brought to the Oak Ridge operation both skill and judgment the United States needed and did not have . . . . We cannot conclude that Carbide . . . [is] so incorporated into the government structure as to become [an] instrumentalit[y] of the United States and thus enjoy governmental immunity." *Id.* *See also United States v. Anderson County*, 575 F. Supp. 574, 578 (E.D. Tenn. 1983), *aff'd*, 761 F.2d 1169, *cert. denied*, 474 U.S. 919 (1985) (noting in *dicta* that "defendants could tax Union Carbide's use of the [plant's] real property. [citing *United States v. County of Fresno*, *supra*] The Court has no reservations concerning a local tax upon Union Carbide.").

The U.S. attempts to distinguish *Boyd* and *New Mexico* because they involved sales taxes, rather than *ad valorem* taxes or possessory interest taxes, like the one assessed here. The U.S. fails to show that the distinction between a sales or use tax and an *ad valorem* or possessory interest tax compels a different result. The possessory interest tax here reaches only that separate beneficial use of government property that GA enjoys; it is not a tax on the property itself. It is a tax on GA's business activity, carried on for profit, to the extent that activity involves government property. In short, because only GA's beneficial use is taxed, the tax is one on the privilege of doing business in California. *See New Mexico supra*, 455 U.S. at

738-39 n.12. It is not a tax on the Federal Government or its property.

The U.S. cites several cases in which *ad valorem* or possessory interest taxes were declared invalid. All are distinguishable.

Several found no beneficial use conferred on private contractors who operated military or nuclear facilities because those contractors were so constrained in their use of the facilities, obtaining no marketable private benefit. *E.g., United States v. Hawkins County*, 661 F. Supp. 857 (E.D. Tenn. 1987), *aff'd on different grounds*, 859 F.2d 20 (6th Cir. 1988), *cert. denied*, 109 S. Ct. 1638 (1989). Here, the expertise GA gains and sells sets it apart from contractors whose only benefit is the contractual fee they receive.

Other cases have turned on findings that no real property interest was conveyed under state laws, which define such real property interests far more restrictively than does California. *E.g., United States v. Jackson County*, 696 F. Supp. 479 (W.D. Mo. 1988) (Missouri law); *United States v. Anderson County*, 761 F.2d 1169 (6th Cir.), *cert. denied*, 474 U.S. 919 (1985) (Tennessee law). Finally, one case turned on the County Assessor's failure to segregate the contractor's benefit from the value of the government property itself. *United States v. State of Colorado*, 460 F. Supp. 1184 (D. Colo. 1978), *aff'd*, 627 F.2d 217 (10th Cir. 1980); *aff'd sub nom. Jefferson County v. U.S.*, 450 U.S. 901 (1981). This led the court to conclude that the Assessor was not taxing the contractor's beneficial use, but was taxing the federally owned property itself. *Id.* at 1188. The U.S. here makes no such attack on San Diego County's assessment of GA's taxable possessory interest.

Because GA does have a taxable beneficial interest from its access to the Doublet device, the assessment is not a tax on federal property itself, and does not violate the supremacy clause of the Constitution. Therefore, the U.S. motion for summary judgment is denied.

B. POSSESSORY INTEREST UNDER CALIFORNIA LAW.

The next issue is whether the tax is valid under California law. Imposed under Cal. Rev. & Tax Code § 107 (West 1987), the County's tax is on GA's "possessory interest" in the device. Whether GA has such a possessory interest depends on objective circumstances, rather than on the language of the contract between the U.S. and GA. *Stadium Concessions, Inc. v. City of Los Angeles*, 60 Cal. App. 3d 215, 223 (1976) ("a reviewing court must measure the situation by an objective standard, rather than by accepting the literal language of the written instrument as controlling the nature of the relationship established"). Thus, the fact that the U.S. retains title to the device and the fact that the U.S.-GA contract does not expressly convey any lease or similar real property interest does not win the argument for the U.S.

The U.S. also argues that G.A. has no possessory interest because it can only use the device in performing the contract, and only with the consent of the U.S. In other words, the U.S. argues that, rather than a lease or periodic tenancy or similar traditional real property interest, G.A. has only a license. But under California law, "a possessory interest may be . . . the interest of . . . a *mere permittee or licensee.*"

Id. at 222 (emphasis in original) (quoting Ehrman & Flavin, *Taxing California Property* § 50 (1967)). This distinguishes the limited real property interests recognized under different states' laws, upon which turned the decisions in *Anderson County* and *Jackson County*. California's broader view of a possessory interest arises from its need to tax in some way the tremendous amount of federally owned property within the state. *See Freeman v. County of Fresno*, 126 Cal. App. 3d 459, 462 (1981). Thus, even though G.A. is only a licensee, it may have a taxable possessory interest under California law. The factors for determining whether this interest exists are exclusivity, independence, durability, and private benefit. *Stadium Concessions, supra*, 60 Cal. App. 3d at 223.

1. *Exclusivity.*

Exclusivity is defined broadly under California law, *see* Cal. Admin. Code tit. 18, § 21(e) (1977), and has been broadly interpreted by California courts. *See Freeman v. County of Fresno*, 126 Cal. App. 3d 459, 461 n.1 (1981). Exclusivity will be found so long as the user may exclude the general public from the subject property. Exclusivity may exist despite concurrent uses, Cal. Admin. Code tit. 18, § 21(e)(2) (1977), and despite the temporary and revocable status of a possessory interest. *Board of Supervisors v. Archer*, 18 Cal. App. 3d 717, 725 (1971). Thus, exclusivity is not defeated because GA's right of access to the device is shared by other research scientists, is limited in duration, and is revocable. Indeed, the right of the U.S. to dictate conditions under which GA may use the device "goes to valuation, not exclusivity."

Freeman, supra, 126 Cal. App. 3d at 465; *Archer, supra,* 18 Cal. App. 3d at 725.

The rationale for defining exclusivity so broadly is found in *Freeman,* where the court explained that "the holders of a valuable use of public property that is tax exempt should contribute taxes to the public entity which makes its possession possible and provides a certain amount of exclusivity." 126 Cal. App. 3d at 463. Thus, for example, since G.A. could call the San Diego police to evict trespassers to the Doublet device, California law holds that G.A. can be forced to pay for the privilege. In short, G.A. enjoys the kind of state-enforced exclusivity which justifies a state tax. Therefore, G.A.'s interest in the device is exclusive under California law.

2. *Independence.*

The second factor, independence, exists since G.A. is left largely unsupervised in its use of the device. Only one U.S. representative is on site, whereas G.A. has hundreds of personnel toiling on the device, carrying out tasks to meet the government's broad one year and five year plans for the device, which themselves are formulated in conjunction with G.A. scientists. Though the U.S. has ultimate control over the device, "much is left to the routine control and supervision" of G.A. *Stadium Concessions, supra,* 60 Cal. App. 3d at 225. Thus, G.A. has sufficient independence.

3. *Durability.*

Durability, the third factor, also requires an examination of all the circumstances of the rationship between the U.S. and G.A. *See Freeman, supra,* 126

Cal. App. 3d at 463 ("The protax trend has found courts testing the requirement of a reasonably certain period of enjoyment by an examination of the agreement in writing *and* the history of the relationship of the parties, thereby finding durability because of the passage of time even though the agreement may have been cancelable at the will of the parties."). Here, GA has been involved with the U.S. for close to twenty years, and the current contract does not expire until 1993. Thus, GA's use is sufficiently durable. The revocability of the agreement, and the possibility of Congressional funding cuts, go only to value of the interest, not its existence. *See Archer, supra,* 18 Cal. App. 3d at 725.

4. *Private benefit.*

The final factor, private benefit, exists here as well. GA receives a fee for its management of the device, as well as substantial and saleable expertise, as detailed in the discussion of GA's beneficial use.

Thus, all four factors are satisfied, and G.A. has a taxable possessory interest in the device so long as the device is an improvement to real property under California law. In other words, if the device is indeed a fixture, as determined by the County Assessor, the assessment is valid under California law.

C. FIXTURE UNDER CALIFORNIA LAW.

1. *Preemption.*

The U.S. first argues that 48 C.F.R. § 52.245-5(c)(4) (1989) preempts any state law characterizing the device as a taxable improvement to real property in the form of a fixture. That section, which is required

to be inserted in all government contracts of this type, provides that government property shall not become a fixture, nor lose its identity as personal property by being attached to real property. Though federal regulations have the preemptive force of federal law, *Fidelity Federal Savings & Loan Assn. v. De La Cuesta*, 458 U.S. 141, 153 (1981), this regulation is merely a required *contract clause*, not a law of general application. Thus, it does not bind third parties such as the County.

If Congress had truly intended to displace state law, it could have expressly provided, as in the *De La Cuesta* case. There, the preemptive regulation required in government contracts was found in a body of regulations preceded by a preamble which read, "federal associations shall not be bound by or subject to any conflicting State law . . . ." 41 C.F.R. §§ 18286, 18287 (1976). The Court relied on this language in concluding that state law was *expressly* preempted by the regulations. *De La Cuesta, supra*, 141 U.S. at 158. The U.S. cites no similarly clear indication of Congressional intent to displace state taxation schemes here.[4] Thus, the assessment is not preempted by federal law.

2. *Fixture v. Personal Property.*

Whether the device is a fixture is a more intriguing question. A device is a fixture under California law if a "reasonable person would consider the item to be

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[4] Indeed, such preemption would render the U.S. contractual obligation to pay state and local taxes a nullity. This further demonstrates that the regulation was not intended to preempt a tax like the one at issue here. If it had been, the U.S. would not have to have agreed to pay local taxes.

a permanent part of the property, taking into account annexation, adaptation, and other objective manifestations of permanence." *Crocker National Bank v. City and County of San Francisco*, 49 Cal. 3d 881, 887-88 (1989). California statutory law specifically defines a fixture as something affixed to real property "by roots, as in the case of trees, vines, or shrubs; or imbedded in it, as in the case of walls; or permanently resting upon it, as in the case of buildings; or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts, or screws." Cal. Civ. Code § 660 (West 1982). Application of both the "reasonable person" factors from *Crocker* and the specific criteria of the statutory definition leads to the conclusion that the device is a fixture.

Here, the Doublet device is *enormous*, apparently the size of a one-story building. It weighs 400-500 tons, and is attached by three steel columns to a 4-6 foot thick slab of steel reinforced concrete, which rests on steel pilings driven down to bedrock. Under the device runs a network of tunnels through which piping and conduit run. Thus, the device is clearly affixed to the real property in a way that indicates permanence.

As for adaptation, the device is housed in a building which, if not specially constructed to house the device, has certainly been modified substantially to accommodate it.[5] The device is fueled by two large

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[5] The parties disagree on how to characterize the building in which the Doublet device is housed. The County calls it a permanent, specially designed structure, while the U.S. calls it a standard, temporary warehouse. However, the U.S. does not dispute the specific dimensions and other physical char-

generators and is serviced by specially constructed water and cooling towers, underground trenches, lines and pumps for liquid gases, and two 20-ton cranes on overhead rails. The device is shielded by specially designed concrete shielding walls to prevent the escape of neutrons into the environment. Thus, the adaptation of this uniquely large, complicated, and cumbersome device indicates permanence as well.

In addition, as clear from the above description, the device is "embedded," "permanently resting," and "permanently attached" to the land within the definitions of Cal. Civ. Code § 660.

The U.S. argues that an issue of fact exists as to whether the device is a fixture. The affidavits, however, illuminate no genuine dispute of material fact; the parties merely draw different conclusions from the facts set forth above. The U.S. does not specifically counter any of those facts with contrary assertions. Thus, this issue is resolved on the County's motion for summary judgment.

The U.S. also points to the contract with GA, which states that the device will not be deemed a fixture, but will remain personal property of the Federal Government. That contractual provision, however, is not dispositive.

California courts hold that such contractual expressions of intent do not bind the Tax Assessor on the question of whether a device is a fixture or not. *See Kaiser Co. v. Reid*, 30 Cal. 2d 610, 630 (1947), modified, 30 Cal. 2d 725 (1947). This seems inconsistent with the California Supreme Court's pro-

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acteristics of the building. Thus, while there is a disagreement over the consequence of several facts, there is no triable disputed issue of fact.

nouncement in *Crocker* that the intent of the parties is the ultimately dispositive factor in considering whether something is permanently affixed to land. 49 Cal. 3d at 881 ("the element of intent is regarded as a crucial and overriding factor, with the other two criteria [annexation and adaptability] being considered only as subsidiary ingredients relevant to the determination of the intent." (quoting *Seatrain Terminals of California, Inc. v. County of Alameda*, 83 Cal. App. 3d 69, 74-75 (1978)). Nevertheless, there is no indication in *Crocker* or any other California Supreme Court authority that *Kaiser* is limited or discredited. Further, if faced with the question today, the California Supreme Court would adhere to *Kaiser*'s conclusion that the parties are not free to immunize a fixture from taxation merely by stating that the property at issue shall remain personal property. Such provisions only bind the parties; they do not bind the Tax Assessor.

Here, despite the government's self-serving contractual language that the Doublet device is personal property, the physical facts are otherwise. Thus, the device is a fixture under California law, and is therefore taxable as an improvement to GA's real property.[6]

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[6] The device is not truly a permanent improvement to the property, since one day in the future, it will have served its purpose, and will be removed, or perhaps replaced by the next generation of experimental fusion reactors. Under California real property law, "permanence" is a term of art, and should not be read or applied literally. Thus, "permanence is to be distinguished from perpetuity. . . . It is sufficient if the article appears to be intended to remain where fastened until worn out, [or] . . . is superseded by another more suitable for the purpose." *Seatrain Terminals of California, Inc. v. County of Alameda*, 83 Cal. App. 3d 69, 77-78 (1978). Here,

D. JURISDICTION OVER VALUATION.

Finally, the County contends that this court has no jurisdiction to consider whether the assessment was properly valued. This is plainly wrong, since the United States is a party, and since it has a contractual obligation to pay the tax. *See United States v. Nevada Tax Commission*, 439 F.2d 435 (9th Cir. 1971). However, it is not clear at this juncture whether the United States has exhausted its administrative remedies. In addition, the actual valuation of the Doublet device has not been put at issue in these motions. Therefore, the court does not pass on the issue of whether the County's valuation of GA's possessory interest is correct.

III. CONCLUSION.

The Court finds that the tax assessments at issue do not violate the supremacy clause of the Constitution; therefore, IT IS HEREBY ORDERED, that the motion for summary judgment by the U.S. is DENIED.

Because there remains at issue the question of whether the County properly valued GA's possessory interest in the Doublet device, IT IS HEREBY ORDERED, that the motion for summary judgment by the County is GRANTED IN PART.

The court finds that GA has a taxable possessory interest in the Doublet device, which is a fixture under California law. Therefore, IT IS HEREBY ORDERED, in accordance with this opinion that these

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though the device may not be on GA's property forever, its presence is sufficiently permanent, since it is intended to remain until the new technology it will spawn renders it obsolete.

issues are decided as a matter of law in favor of the County.

The court finds that it has jurisdiction to review a final administrative decision as to whether the County correctly valued GA's interest in the Doublet service. However, the court does not reach or decide the issue of whether that valuation was correct, but leaves that decision for further proceedings.

Accordingly, IT IS HEREBY ORDERED, that the motion practice cut-off date is continued to August 6, 1990, and the trial date is continued to August 28, 1990.

/s/ Howard B. Turrentine,
HOWARD B. TURRENTINE
Dated: June 21, 1990 United States District Judge

APPENDIX D

[Filed Sep. 27, 1993]

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. CV 89-0085 T (CM)

UNITED STATES OF AMERICA, PLAINTIFF

v.

COUNTY OF SAN DIEGO, ET AL., DEFENDANTS

ORDER GRANTING SUMMARY JUDGMENT

I

FACTUAL BACKGROUND

General Atomics ("GA") manages and operates a federally-funded nuclear fusion device. GA's use of the device creates a taxable possessory interest under California law because GA gains knowledge and expertise in fusion research. The County defendants ("County") constitutionally levy a tax on this private interest in the device. *United States v. County of San Diego*, 965 F.2d 691 (9th Cir. 1992). The remaining issue is whether the County used an improper method to value GA's possessory interest.

The County moves for summary judgment on the ground that the federal issues are resolved and the United States ("US") cannot challenge the valuation methodology under state law. The County contends that an action cannot be maintained under state law unless the taxes were paid and timely claims for refund filed within four years of payment. GA paid the taxes for tax years 1978, 1979, 1980, 1981, 1987 and 1988 more than four years ago, and it did not file a claim for refund for those years. GA has not paid the tax for any other tax year.

II

DISCUSSION

A. *No Constitutional Issue Remains*

The County relies on *United States v. California*, 113 S.Ct. 1784 (1993), in which the US challenged a state tax assessment levied on a federal contractor. Although the US was contractually obligated to pay the tax, the US could not raise a " 'colorable constitutional challenge' " to the tax assessment. *Id.* at 1787. The United States Supreme Court concluded that the US did not have a federal cause of action "to challenge a state tax on state-law grounds simply because it is the Government." *Id.* at 1792.

The County correctly contends that the US's constitutional arguments have been resolved in this case. *County of San Diego, supra*, 965 F.2d 691. Under the principles set forth in *California*, there is no other federal cause of action under which the US may challenge the valuation methodology used by the County. *California, supra*, 113 S.Ct. at 1792. The valuation issue is governed by state law, and there-

fore the challenge is a challenge to a state tax on state-law grounds. The US's arguments to the contrary are unpersuasive.

The declaration of the US's appraiser concludes that an error in valuation resulted in the imposition of an "excess" tax. However, the cases cited by the US do not support the contention that an "excess" tax is a tax on the US. The US relies on three cases, *United States v. Colorado*, 460 F. Supp. 1184 (Colo. 1978), *aff'd* 627 F.2d 217 (10th Cir. 1980), *aff'd sub nom. Jefferson County v. United States*, 450 U.S. 901 (1981); *County of Los Angeles v. Assessment App. Bd.*, 16 Cal. Rptr. 2d 479 (1993); and *Service America Corp. v. County of San Diego*, 19 Cal. Rptr. 2d 165 (1993).

The only case involving a constitutional issue is *Colorado*, and the state tax there was held invalid because the user of federal property was taxed " 'in the same amount and to the same extent' as if it were the owner of the property." 460 F. Supp. at 1188. GA is not taxed as if it were the owner of the device. The possessory interest tax is levied on the "possessory use interest in the device and not the underlying value of the device itself." *County of San Diego, supra*, 965 F.2d at 694.

As there is no support for the US's contention that a constitutional issue exists, there is no federal claim on which the US may proceed.

B. *The US Cannot Proceed Under California Law.*

Nor is there a state cause of action on which the US may proceed. In *California*, the Court held that the US could challenge a state tax assessment paid on behalf of a federal contractor, if the US was subrogated to " 'a right free of a pre-existing infirm-

ity.' " 113 S.Ct. at 1791 quoting *Guaranty Trust Co. v. United States*, 58 S.Ct. 785 (1938). Since the contractor in *California* failed to fully comply with the "conditions precedent to a cause of action for a tax refund" under state law, the contractor and the US were barred from bringing suit. *Id.* at 1787.

The "conditions precedent" to a suit challenging a possessory interest tax assessment include (1) payment of the taxes assessed and (2) filing of claims for refund within four years of payment. Cal. Rev. & Tax. Code, §§ 5097, subd. (a), and 5142. A suit cannot be maintained unless these conditions were met prior to filing suit. *Id.; see also* Ehrman & Flavin, *Taxing California Prop.*, (Third Ed. (1989)) §§ 30.02 and 30.04.

These "conditions precedent" to bringing or maintaining an action have not been met for any tax year. Taxes were paid for tax years 1978, 1979, 1980, 1981, 1987 and 1988, but claims for refund were not submitted within four years of the payments. An action to challenge the assessments for these tax years is barred by state law. Cal. Rev. & Tax. Code, §§ 5097, subd. (a), and 5142. Taxes have not been paid for any other year. Consequently, the US is "not subrogated to 'a right free of a pre-existing infirmity' " for any tax year.

III

CONCLUSION

The Court need not reach the merits of the US's remaining claim, that an error occurred in valuing GA's possessory interest. The Court finds that the US cannot proceed under federal law, because a challenge to the valuation methodology does not raise a

constitutional issue. The Court further finds that the conditions precedent to suit under state law were not met. There are no genuine issues of material fact as to whether the US can proceed under either federal or state law. Accordingly, IT IS HEREBY ORDERED, that the motion for summary judgment by the County is GRANTED.

/s/ Howard B. Turrentine
HONORABLE HOWARD B. TURRENTINE
United States District Judge

Dated: 9/27/93

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 93-56650

CT/AG# : CV-89-00085-RCM

UNITED STATES OF AMERICA
PLAINTIFF-APPELLANT

v.

COUNTY OF SAN DIEGO
DEFENDANT-APPELLEE

Appeal from the United States District Court
for the Southern District of California
(San Diego)

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California (San Diego) and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is AFFIRMED.

Filed and entered April 24, 1995.

APPENDIX F

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. Article VI, Clause 2, of the Constitution provides:

> This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

2. 28 U.S.C. 1345 provides:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

3. Sections 104, 105 and 107 of the California Revenue and Taxation Code, Cal. Code Ann. (West 1987), provide in pertinent part:

> § 104. *Real estate or real property*
>
> "Real estate" or "real property" includes:
> (a) The possession of, claim to, ownership of, or right to the possession of land.
>
> * * * *
>
> (c) Improvements.
>
> § 105. *Improvements*

"Improvements" includes:

(a) All buildings, structures, fixtures, and fences erected on or affixed to the land.

* * * *

§ 107. *Possessory interests; security for payment of taxes; leasehold estates; collection procedures.*

"Possessory interest" means the following:

(a) Possession of, claim to, or right to the possession of land or improvements, except when coupled with ownership of the land or improvements in the same person.

(b) Taxable improvements on tax-exempt land.

* * * *

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Supreme Court, U.S.
FILED
AUG 18 1995
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No. 95-128

In The

Supreme Court of the United States

October Term, 1995

UNITED STATES OF AMERICA,

Petitioner,

v.

COUNTY OF SAN DIEGO, CALIFORNIA; GREGORY J. SMITH, SAN DIEGO COUNTY ASSESSOR; and PAUL BOLAND, SAN DIEGO COUNTY TAX COLLECTOR,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the use of federal property by a private research firm, to conduct research for profit in its own facilities, constitutes a taxable beneficial use of federal property.

2. Whether it is constitutional to calculate a state tax on the private beneficial use of federal property based on the value of the property.

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Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

TO THE HONORABLE SUPREME COURT:

Defendants/respondents County of San Diego, a political subdivision of the State of California, and its assessor and tax collector, submit this brief in opposition to the petition for a writ of certiorari submitted by plaintiff/petitioner United States of America.

OPINIONS BELOW

The decisions of the Ninth Circuit Court of Appeals (App., 1a-10a, 11a-26a) are reported at 965 F.2d 691 and 53 F.3d 965.[1] The opinions of the district court (App., 27a-44a, 45a-49a) are unreported.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. section 1254(1).

The jurisdiction of the Ninth Circuit Court of Appeals was invoked on the first occasion under 28 U.S.C. section 1292(b), as a permissive interlocutory appeal, and subsequently under 28 U.S.C. section 1291, as an appeal as a matter of right from a final order of the district court granting summary judgment in favor of the County of San Diego.

The jurisdiction of the District Court for the Southern District of California was invoked under 28 U.S.C. sections 1331 and 1345.

The County determined that the device is a real property improvement, which General Atomics uses to earn millions of dollars in profit and to acquire invaluable expertise.

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[1] "App." refers to the Appendix to the United States' Petition for Certiorari.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional and statutory provisions involved are Article VI, Clause 2, of the United States Constitution and sections 104, 105, and 107 of the California Revenue and Taxation Code. App., 51a-52a.

STATEMENT OF THE CASE

The United States of America seeks a writ of certiorari to review a decision of the United States Court of Appeals for the Ninth Circuit, which affirmed the district court's grant of summary judgment to the County of San Diego. The United States' suit challenges the constitutionality of the California possessory interest tax which the County of San Diego imposes on a federal contractor, General Atomics.

I. Factual Background

General Atomics is a private research and development firm which conducts fusion research for profit. As part of its commercial enterprises, General Atomics designed and constructed a nuclear fusion "device" which it uses to conduct research under federal contracts. General Atomics earns millions of dollars in profit and gains marketable expertise from its use of the 400-500 ton device, which is a real property improvement to General Atomics' private facilities. App., 2a, 5a-7a, 13a, 18a-19a. California cannot impose a real property tax on the device because it is owned by the federal government. However, California does impose a possessory interest

tax on the private beneficial use of such real property improvements. Cal. Rev. & Tax. Code, §§ 104, 105, 107.

Consequently, the County of San Diego imposed a possessory interest tax on General Atomics' beneficial use of the device in its San Diego facilities.[2]

The possessory interest tax is calculated based on the value of the device, but the calculation takes into account the contractual restrictions on General Atomics' use of the device so that only the private use is taxed. Pet., 5 n.3.[3] General Atomics paid taxes of $568,002.12, including penalties and interest, for tax years 1978-81 and 1987-88. This amount was reimbursed by the federal government as provided by contract. General Atomics did not make payment on the remaining tax bills, which total $721,979.55 for tax years 1982-85 and 1989. App., 13a.

II. Proceedings Below

The United States commenced this action in 1989, seeking a declaratory judgment that (i) the possessory interest tax is imposed on federal property in violation of the federal constitution; (ii) General Atomics does not

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[2] The County of San Diego has taxed General Atomics' use of two nuclear fusion devices. The first device operated from 1978 until 1984. The second device has remained in use since it was built in 1986. Since the County of San Diego taxed both devices in the same manner, no distinction has been made between the devices in this litigation. They are referred to collectively as the "device."

[3] "Pet." refers to the United States' Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

have a possessory interest under state law; and (iii) the methodology used to value the possessory interest is improper. CR 1.

The district court granted summary judgment in favor of the County of San Diego on the first two issues, finding that the tax was not imposed on federal property (the device) but on General Atomics' "beneficial use" of the device, which was taxable under state law. App., 27a-44a. The Court explained that the use of the device is beneficial not only because General Atomics receives large fees for its work with the device, but because "[General Atomics] gains and indeed sells . . . knowledge and expertise in fusion research" which allows General Atomics to market itself "to various customers, including the United States and foreign governments." App., 31a. The United States unsuccessfully moved for reconsideration of this decision, on the ground that the tax was imposed on General Atomics' "knowledge and expertise" rather than on General Atomics' use of the device. CR 38.

The United States then took an interlocutory appeal on the issue of whether General Atomics had a taxable possessory interest in the device. CR 58. In its decision affirming the district court's findings, the Ninth Circuit Court of Appeals agreed that General Atomics benefitted from use of the device by earning substantial profits and acquiring valuable expertise which it then markets. App., 18a-19a. The court concluded that "the County's taxation of this beneficial use is not a tax on federal property, but rather a tax on an 'essentially independent commercial enterprise.' " App., 19a.

On remand, the United States moved for leave to amend its complaint to allege that the tax discriminates against General Atomics because no other contractor is taxed for "acquiring expertise." CR 68. The district court denied this motion. The County subsequently moved for summary judgment on the remaining issue, i.e., whether the methodology employed to value the possessory interest was erroneous. CR 95. This issue presented a question of state law, on which the United States could not proceed because it failed to first exhaust state administrative remedies. The United States opposed the motion, arguing that the issue of valuation presented a constitutional question because the tax exceeded the value of General Atomics "knowledge" and thus was necessarily imposed on federal property. CR 88. Rejecting this argument, the district court granted the County of San Diego's motion and entered judgment in favor of the County.

On appeal of the final judgment, the Ninth Circuit Court of Appeals affirmed the district court's findings on all issues. The court of appeals rejected the contention that the tax is imposed on "knowledge," stating that "even though the possessory interest is valuable because of the fee and experience General Atomics reaps, the tax is based on the possessory interest itself. . . . " App., 8a. The court of appeals also rejected the contention that the valuation methodology presented a constitutional issue, concluding that "[i]t is not unconstitutional for the County to calculate the value of General Atomics' possessory interest by turning to the value of the device." App., 9a.

SUMMARY OF ARGUMENT

The United States fails to present a basis for review of the Ninth Circuit's decision. The decision does not narrow federal tax immunity, or depart from earlier decisions, as the United States contends. The decision is consistent with existing federal law, because the possessory interest tax is imposed on General Atomics' private beneficial use of the device rather than on General Atomics' "acquisition of knowledge." Federal courts have long recognized that the states may tax the private beneficial use of federal property, and that the tax may be based on the value of the property being used.

REASONS FOR DENYING THE PETITION

I. The Decision Is Consistent With the Long Line Of Federal Cases Which Hold That A Tax On The Private Beneficial Use Of Federal Property Is Constitutional.

The United States mistakenly asserts that the Ninth Circuit's decision narrows federal tax immunity and "departs from earlier federal decisions." Pet., 13-14. On the contrary, the decision is consistent with the long line of federal cases which hold that a tax on the private beneficial use of federal property is constitutional. See, *United States v. New Mexico*, 455 U.S. 720 (1982).

In *New Mexico*, this Court was asked to decide whether a state may tax federal contractors for using federal property in performing management and other contract services at federally-owned atomic laboratories. Starting with the underlying constitutional principle that

a state may not tax the United States directly, the Court stated that "the limits on the immunity doctrine are, for present purposes, as significant as the rule itself." Id. at 734. After reviewing its earlier decisions, the Court explained that "where a use tax is involved, immunity cannot be conferred" on a contractor even if the contractor uses federal property to provide goods or services to the federal government. Id. "In such a situation the contractor's use of the property 'in connection with commercial activities carried on for profit' is 'a separate and distinct taxable activity.' " Id. at 734-35. The Court concluded that its decisions left room for tax immunity "in only one circumstance: when the levy falls directly on the United States itself, or on an agency or instrumentality so closely connected" that the two cannot be viewed as separate entities. Id. at 735.

General Atomics' use of the device is taxable under these principles, because General Atomics is not an agent of the United States, and it undeniably uses the device "in connection with commercial activities carried on for profit." Id. at 734-35. General Atomics is in the business of conducting research for profit, and it earns millions in profit every year from using the device under its contracts with the federal government. App., 13a. General Atomics also gains expertise and a reputation which make it highly marketable in the field of fusion technology. In fact, during the period relevant to this litigation, 1980 through 1989, the Fusion Division of General Atomics received contract revenues of nearly one-half billion dollars. CR 38. (Overskei decl. at p. 3.) This figure includes $351,645,100.00 received under the contracts covering the use of the device, $68,573,100.00 received

under other federal contracts, and $24,323,900.00 received from commercial firms. CR 38. (Overskei decl. at p. 3.)

There is no doubt that the use of the device has been a key factor in the success of General Atomics' fusion program. In its advertisements, General Atomics refers to the device as the "heart" of its fusion program, which it describes as "on the cutting edge" of fusion technology. CR 22. (exh. to Overskei Depo.) Such beneficial use of federal property is clearly taxable under the principles set forth in *New Mexico.* As this Court held in *New Mexico,* the reimbursement of expenses, payment of a profit, and the acquisition of expertise are all evidence of a taxable beneficial use. 455 U.S. at 723-724 and n.3.

The United States asserts that General Atomics' use of the device is not beneficial because General Atomics "merely manages" the device. Citing *United States v. Colorado,* 627 F.2d 217 (10th Cir. 1980), aff'd sub nom. *Jefferson County v. United States,* 450 U.S. 901 (1981), the United States argues that under federal law, a "tax that is assessed on a contractor who merely manages federal property" is an unconstitutional tax on federal property. Pet., 16. The United States' argument fails because *Colorado* does not invalidate a use tax because the federal contractor "merely managed" federal property. *Colorado* invalidates the tax because the tax statute assessed users of federal real property "as though the [users] were the *owner[s]* of such property." 627 F.2d at 218; emphasis added. The Court found that the tax was not imposed on the contractor's "use" of the property, because the use was limited by contract. Id. This Court concluded a tax "under the provisions of [this state tax statute], is in reality a tax on the property itself. . . . " Id.

Colorado does not apply here, because General Atomics is not taxed on the entire value of the device. General Atomics is taxed only on its possessory interest in the device, an interest which is substantially less than the value of the device itself. In fact, the tax has varied from year to year based on General Atomics' use of the device, and it was not imposed at all in the year the device was not operational. CR 1 at 9-10. Since the tax falls only on General Atomics' use of the device, the tax does not suffer from the same constitutional infirmity as the statute in *Colorado*. App., 15a-16a.[4]

II. The Decision Is Consistent With Previous Decisions Of This Court Which Hold That The Calculation Of A State Use Tax May Be Based On The Value Of Federal Property.

The United States also argues that, if General Atomics has a beneficial use of the device at all, General Atomics has "benefitted" by using the device in only one instance, i.e., in the receipt of consulting fees amounting to $176,000.00. The United States therefore concludes that the possessory interest tax is excessive because the tax exceeds the amount of the "benefit." Pet., 20-21.

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[4] The United States also relies on *United States v. Anderson County*, 761 F.2d 1169 (6th Cir. 1985), for the proposition that a federal contractor who manages federal property cannot have a separate taxable interest in the property. Pet., 17-18 n.9. *Anderson County* does not stand for this proposition. *Anderson County* invalidates a state tax because the state supreme court had already determined that the contractor did not possess a taxable interest under state law. 761 F.2d at 1172-75.

This argument makes no sense, because the tax is imposed on the use of the device, not on the fees received. The receipt of the fees is merely evidence that a beneficial use exists. Moreover, the United States seriously mischaracterizes the true extent of General Atomics' beneficial use. While General Atomics receives fees for related work, it also benefits from using the device under federal contract – earning nearly $352 million for its work with the device between 1980 and 1989, including $2.5 million per year in profit. CR 38. (Overskei decl. at p. 3.) In addition to these contract fees, General Atomics has gained invaluable experience which it markets to obtain other federal and private contracts for fusion-related research or technologies. CR 38. (Overskei decl. at p. 3.)

The possessory interest tax on this beneficial use is not "constitutionally flawed" because it is based on the value of the device, as the United States argues. This Court held long ago that a state use tax may be based on the value of the federal property being used. *United States v. City of Detroit*, 355 U.S. 466, 470 (1958). In *Detroit*, the federal government argued that a state use tax which is measured by the value of federal property "should be treated as nothing more than a contrivance to lay a tax on that property." Id. This Court rejected this argument, stating that "[a] tax for beneficial use of property, as distinguished from a tax on the property itself, has long been a commonplace in this Country. [ ] In measuring such a use tax it seems neither irregular nor extravagant to resort to the value of the property used. . . . " Id.

This principle was discussed again in *United States v. Fresno*, 429 U.S. 452, 462, n.10 (1977), a case which upheld

the imposition of the very tax at issue here, California's possessory interest tax. Id. at 455-456. In *Fresno*, the possessory interest tax was applied to federal employees who lived in government housing and the tax was calculated based on the value of the homes. Id. at 456. Noting that a use tax may be measured by the value of the federal property being used, the Court stated "[a]ppellee counties have sought to tax only the individual appellants' interests in the [housing] and have reduced their assessments to take account of the limitations on the use of the houses imposed by the Government." 429 U.S. at 462 n.10.

The tax assessments here are constitutional because they are computed in the same manner as the assessment in *Fresno*. The assessments against General Atomics are based on the value of the federal property being used, but take into account the limitations on the use of the device. App., 9a, CR 89. As the United States states in its petition for certiorari, the tax assessor calculates the value of the possessory interest by determining the cost of the property being used, the average life and salvage value of the property, the duration and extent of the taxpayer's right to use the property, any reversionary interest, and the appropriate allowance for depreciation. Pet., 5 n.3. The United States' own expert on valuation explained that the County of San Diego applied a "usage factor" to calculate General Atomics' interest in the device each year. CR 89. The expert testified that a usage factor of 30% was applied in tax year 1978-79, the only tax year for which the expert provided a figure. CR 89. (Steel decl., at pp. 2-3.)

Such a method of calculating the possessory interest tax is constitutional under well settled law. App., 9a. Consequently, there is no need to revisit this issue.

III. The Issues Presented Are Not Of Broad Significance.

The questions presented to this Court by the United States simply are not of "broad significance" because the body of federal law governing tax immunity is well-established, and the United States presents no new issues. While the United States argues that billions of dollars in federal property is in private hands and "[a]n annual tax on even a portion of the value of this property . . . would meaningfully disturb 'the absolute federal immunity from state taxation' " (Pet., 24), federal law is settled on this point as well.

A tax is not unconstitutional because it imposes an "economic burden on a federal function" by taxing those who "deal with the federal Government." *Fresno*, supra, 429 U.S. at 462. Nor is tax immunity conferred on federal contractors because the tax is paid with federal funds. *New Mexico*, supra, 455 U.S. at 735. In *New Mexico*, this Court explained the immunity principles derived from its earlier decisions:

> "If the immunity of federal contractors is to be expanded beyond its narrow constitutional limits, it is Congress that must take responsibility for the decision, by so expressly providing. . . . Absent congressional action, we have emphasized that the States' power to tax can be denied only under 'the clearest constitutional mandate.' [ ]" Id. at 737-38.

Since there is no constitutional prohibition against the tax involved here, and since Congress has not acted to extend federal tax immunity to General Atomics, the tax is permissible under settled principles of federal law.

While the United States complains of the burden of state taxation, it voluntarily assumed the tax burden here, when it agreed to reimburse General Atomics for the possessory interest taxes. Furthermore, while the United States implies that such state taxation is a great burden on the federal government, the burden may not be nearly as significant as the United States implies. The taxes imposed on General Atomics for tax years 1980 through 1989, including penalties and interest, total only $1.3 million. This is less than one-half of one percent of the $352 million in contract payments made to General Atomics during the same time period.

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1995

UNITED STATES OF AMERICA, PETITIONER

v.

COUNTY OF SAN DIEGO, CALIFORNIA; GREGORY J. SMITH, SAN DIEGO COUNTY ASSESSOR; and PAUL BOLAND, SAN DIEGO COUNTY TAX COLLECTOR

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. Respondents err in contending that the decision in this case is an ordinary application of the settled principle that a State may tax the "private beneficial use of federal property" (Br. in Opp. 7). As this Court has explained, the "vital thing" in determining whether a taxable "beneficial use" exists is whether the federal contractor is "using the property in connection with its own commercial activities" (*United States* v. *Township of Muskegon*, 355 U.S. 484, 486 (1958)) or is, instead, using the property "*only* in performing [its] job" (*United States* v. *County of Fresno*, 429 U.S. 452, 466 n.15 (1977)). When the contractor "is merely performing its contractual obligations on government

owned property," it cannot be said that the contractor has a "private beneficial use" of the property. *United States* v. *Colorado*, 627 F.2d 217, 220 (10th Cir. 1980), aff'd, 450 U.S. 901 (1981). See Pet. 15-16.

In the present case, the contractor constructed, managed and operated property for the government but was not permitted any independent, commercial use of that property (Pet. App. 28a; Pet. 4). The income that the contractor received from its federal contract work is taxable by the States; but the federal property that the contractor managed is not. *United States* v. *Colorado*, 627 F.2d at 220. The annual *ad valorem* tax on the value of the federal property that the contractor managed was unconstitutionally imposed "on property owned by the United States." *Id.* at 221.

The court of appeals recognized that the federal contractor in this case was *not* permitted to use the government's property in independent commercial activities. The court of appeals nonetheless reasoned that the contractor could be taxed for the value of that property because of the "valuable knowledge" and "expertise" that the contractor obtained from its work for the government (Pet. App. 18a, 20a, 22a). For the reasons explained at length in the petition—which respondent does not address or rebut—that analysis is a marked departure from precedent and conflicts with the decisions of this Court and other courts of appeals. See Pet. 16-20.

2. a. In contending that the State's annual *ad valorem* tax is properly apportioned to the contractor's "beneficial personal use" of the government's property, respondents incorrectly describe certain relevant facts. First, respondents suggest that the state tax is properly imposed on the value of the federal property because the federal contractor re-

ceived several hundred million dollars "under the contracts covering the use of the device" (Br. in Opp. 8). The contracts did *not*, as respondents' statement suggests, involve "use of the device" by the federal contractor. Instead, the contracts involved the construction, maintenance and operation of the device by the contractor under the specific direction and control of the federal government (Pet. App. 28a). No revenues were obtained by the contractor from any independent "use" of the device.

The revenues referred to by respondents consisted entirely of reimbursement for the costs of construction and operation of the federal property and the contractor's annual service fee (Pet. App. 12a-13a). These revenues *are* subject to state tax. What the State may not tax, but is attempting to tax in this case, is the property of the United States itself.

Respondents go on to state that the federal contractor received significant additional revenues from fusion research, and they imply that these revenues were the result of the knowledge and expertise developed from the contractor's work with the Doublet device. See Br. in Opp. 8. The affidavit on which respondents rely, however, states specifically that these other sources of revenue were *not* obtained from use of the Doublet device and also were *not* obtained from application of the "knowledge" or "expertise" the contractor acquired in performing the government contract. The affidavit explains that virtually all of the contractor's commercial revenues were derived from private and government contracts that did *not* relate to the Doublet device and that "only $176,000 [of its commercial revenues] involved Doublet-derived technology" (CR 38, Overskie Decl. at 3).

The tax that respondents assessed bears no relationship to the value of the incidental "beneficial personal use" described by the court of appeals. The tax exceeds by several times the total economic benefits ($176,000) that the contractor assertedly derived from the "knowledge" and "expertise" resulting from its management and operation of the government's property. Because the tax assessed by respondents does not meaningfully "sever" or "segregate" the value of the alleged "beneficial personal use" from the value of the property itself, the tax unconstitutionally falls on property values belonging solely to the United States. See, *e.g.*, *United States* v. *County of Allegheny*, 322 U.S. 174, 187 (1944); *United States* v. *Hawkins County*, 859 F.2d 20, 23 (6th Cir. 1988).

b. Respondents do not dispute that the decision in this case conflicts with *County of Allegheny* and *Hawkins County*. Indeed, although we relied on those decisions in the petition (Pet. 22-23 & n.14), respondents' brief simply ignores them.

Respondents contend (Br. in Opp. 11-12) that the decision in this case is consistent with this Court's decision in *United States* v. *City of Detroit*, 355 U.S. 466, 470 (1958). That contention is incorrect for the reasons we explain in the petition (Pet. 21-22). When, as in *City of Detroit*, the contractor is given free and unrestricted commercial use of federal property in conducting a manufacturing business, a tax on the full value of the property is sustainable. *Ibid.* That decision does not support, however, a suggestion that the States may impose a tax on the value of federal property that is placed in the hands of a contractor who is *not* allowed to use the property in independent, commercial endeavors. Instead, as this Court has

held on several occasions, when the contractor's "use" of the property is limited, the value assigned to that "use" must be "severed from" the value of the property belonging to the government (*United States* v. *County of Fresno*, 429 U.S. 452, 466 (1977)). Moreover, in this case, the contractor had no right at all to use the fusion device in any commercial activity; it had only the duty to manage the use of the device for the government. See Pet. 4.

3. The expansive rationale adopted by the court of appeals would make essentially all property of the United States that is placed in the custody of federal contractors or employees subject to annual state *ad valorem* taxes. There is no logical basis for distinguishing the "valuable knowledge" and "expertise" gained by the manager of the government's experimental fusion device from the "valuable knowledge" and "expertise" gained by a federal contractor or employee who has custody or possession of other types of government property. See Pet. 23 & n.15.

As the petition notes (Pet. 24), the value of federal property that would be subject to annual state property taxes under the reasoning of the decision in this case is enormous. Respondents contend, however, that the burden of such taxes must be unimportant because the United States "voluntarily assumed the tax burden" by agreeing to reimburse federal contractors for valid state taxes (Br. in Opp. 14). That contention is based on a flawed economic analysis.

The United States has no option, other than litigation, to avoid the burden of unconstitutional state taxes imposed on its contractors. If the United States declined to reimburse federal contractors for such taxes, the economic burden of the taxes would still flow to the United States. When state property

taxes are imposed on federal property in the hands of a contractor, the contractor will either demand reimbursement or raise its contract price to cover the additional costs that the taxes represent. Taxes imposed on contractors—like other types of unavoidable costs—eventually flow to the consumer of the service being taxed, either directly (through reimbursement) or indirectly (through higher contract prices). See *Boyle* v. *United Technologies Corp.*, 487 U.S. 500, 511-512 (1988). A contractor will not perform a service for which it cannot obtain a payment that encompasses all of its costs (plus a profit). The burden of unconstitutional taxes on federal property thus falls ultimately on the United States as a matter of economic reality, not from any "voluntary" assumption of that burden by the United States.

Because the decision in this case conflicts with decisions of this Court and of other courts of appeals, and because the rationale employed by the court of appeals would materially erode the constitutional immunity of the United States from taxation by the States, further review by this Court is warranted. See Pet. 14-24.

* * * * *

For the reasons stated herein and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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